Office-Supreme Court, U.S.
FILED
OCT 24 1962
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

No. 553

ASSOCIATED TELEPHONE AND TELEGRAPH COMPANY,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JOHN J. BOLAND,
WINTHROP, STIMSON, PUTNAM & ROBERTS
40 Wall Street
New York 5, N. Y.
Attorney for Petitioner

Of Counsel:
THEODORE F. BROPHY
ROBERT ADELSON
730 Third Avenue
New York, N. Y.

ROBERT P. ADELMAN
40 Wall Street
New York, N. Y.

October 24, 1962

Pandick Press, Inc., 22 Thames St., New York 6, N. Y., U. S. A.

INDEX.

	PAGE
OPINIONS BELOW	1
JURISDICTION	2
QUESTION PRESENTED	2
STATUTES AND TREATY INVOLVED	2
STATEMENT	3
REASONS FOR GRANTING THE WRIT	6
I. The Decision Below Conflicts with Rules Enunciated by This Court with Respect to the Meaning and Application of §316(a) and the Interpretation of §902(a) of the Internal Revenue Code of 1954	6
A. Conflict of the decision below with the rule of this Court in *Comm'r.* v. *Est. of Bedford*, 325 U. S. 283 (1945): The general definition of "dividend" in §316(a) by its clear terms is applicable to the entire income tax subtitle	7
B. Conflict of the decision below with the rule of this Court in *American Chicle Co.* v. *U. S.*, 316 U. S. 450 (1942): §902 should be interpreted as written to avoid double taxation	8
II. The Decision Below Conflicts with Rules Enunciated by This Court in *Bingham Tr.* v. *Comm'r.*, 325 U. S. 365 (1945) and *Merrill* v. *Fahs*, 324 U. S. 308 (1945): Clearly Related Sections of Tax Statutes Should Be Construed in *Pari Materia*	9
A. §902(a) is clearly related to §§901(a) and 904(a) and should have been construed in *pari materia* therewith by the Court below	9

PAGE

B. §902(a) is clearly related to §902(b), and should have been construed in *pari materia* therewith by the Court below 11

C. The foreign tax credit provisions of the 1954 Code (including §902(a)) are closely related in purpose to the Income Tax Convention between the United States and Canada, and should have been considered in *pari materia* therewith by the Court below 13

III. The Decision Below Conflicts with the Rule Enunciated by This Court That Courts May Not Add to or Alter Statutory Language 14

A. Conflict of the decision below with the principles enunciated by this Court in *Hanover Bk.* v. *U. S.*, 369 U. S. 672 (1962) and *Lewyt Corp.* v. *Comm'r.*, 349 U. S. 237 (1955): Courts may not, by judicial legislation, deny benefits of which they disapprove 14

B. Conflict of the decision below with the rule of this Court in *Helvering* v. *Bliss*, 293 U. S. 144 (1934) and *U. S.* v. *Pleasants*, 305 U. S. 357 (1939): One statutory provision granting tax relief is not modified by another provision granting tax relief, unless required by specific statutory language 17

IV. The Question Presented Is of Fundamental and Continuing Importance to the Interpretation and Administration of the Foreign Tax Credit Provisions of the 1954 Code 20

CONCLUSION 22

APPENDIX A. Statutes and Treaty A-1

APPENDIX B. Opinion of the Court below B-1

APPENDIX C. Judgment of the Court below C-1

CITATIONS.

PAGE

Cases:

American Chicle Co. v. *U. S.*, 316 U. S. 450 (1942) 8, 9, 18

Bingham Tr. v. *Comm'r.*, 325 U. S. 365 (1945) 9, 11, 12, 14

Camm rano v. *U. S.*, 358 U. S. 498 (1959) 11, 21

Comm'r. v. *Est. of Bedford*, 325 U. S. 283 (1945) 7

Fowler Hosiery Co., Inc. v. *Comm'r.*, 301 F. 2d 394 (7th Cir. 1962) 5, 9, 14, 17, 18, 20, 21

Freeport Sulphur Co. v. *U. S.*, 163 F. Supp. 648 (Ct. Cl. 1958) 5, 9, 14, 18, 20, 21

Hanover Bk. v. *U. S.*, 369 U. S. 672 (1962) 14, 15

Helvering v. *Bliss*, 293 U. S. 144 (1934) 17, 20

Helvering v. *Campbell*, 139 F. 2d 865 (4th Cir. 1944) 6, 10, 11

Helvering v. *Winmill*, 305 U. S. 79 (1938) 11

I. B. Dexter, 47 B. T. A. 285 (1942) Acquiescence 1948-2 Cum. Bull. 1 ..... 10, 11

James H. Brace, 11 T. C. M. 906 (1952) 10, 11

Lewyt Corp. v. *Comm'r.*, 349 U. S. 237 (1955) 14, 15

Merrill v. *Fahs*, 324 U. S. 308 (1945) 9, 11, 12, 14

U. S. v. *Pleasants*, 305 U. S. 357 (1939) 17, 18

Statutes:

28 U. S. C.:

§1254(1) 2

§1346 4

§2101(c) 2

Internal Revenue Code of 1954:

§269 16

§316(a) 2, 5, 6, 7, 8, 15, 18

§331(a) 2, 7, 18, 19

§901(a) 2, 4, 5, 9

PAGE

§901(b) 2, 4, 10
§902(a) 2, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 16, 18
§902(b) 2, 5, 11, 12
§904(a) 2, 4, 6, 9, 10, 11
§1201(a) 19
§1221 19
§1222 19
§7852(d) 14

Internal Revenue Code of 1939:
§117(c) 19

Revenue Act of 1942, c. 619, 56 Stat. 798:
§150(c) 19

Revenue Act of 1924, c. 234, 43 Stat. 253:
§201(c) 18

Revenue Act of 1921, c. 136, 42 Stat. 227:
§201(a) 18
§238(e) 8, 18, 19

Treaty:

Income Tax Convention between the United States and Canada, 56 Stat. 1399, as amended:
Article XI 2, 3, 13
Article XV 2, 13, 14
Article XVII 14
Protocol, paragraph 6 ..... 3, 13

Miscellaneous:

Beauregard, *Distributions in Liquidation as Dividends in the Foreign Affiliate Tax Credit of the 1954 Code*, 41 Virginia L. Rev. 731 (1955) 6

11 *U. S. Tax Week*, No. 33 (published by Fallon Law Book Co., Inc.), August 17, 1962, at pp. 1407 ff. 20

PAGE

Mertens, *Law of Federal Income Taxation* (Zimet, Stanley & Kilcullen Revision, 1962), Vol. I, §9.79 17

61 Cong. Rec. 7184 (1921) 8

Hearings on Revenue Revision before the House Committee on Ways and Means, 81st Cong., 2d Sess. 275 (1950) 18

T. D. 5206, §7.31(b), 1943-1 Cum. Bull. 526, 539 13

Rev. Rul. 54-15, 1954-1 Cum. Bull. 129 6

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

No.

ASSOCIATED TELEPHONE AND TELEGRAPH COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

Petitioner prays that a writ of certiorari issue to review that part of the judgment of the United States Court of Appeals for the Second Circuit, entered in the above-entitled case on July 30, 1962, which reversed the judgment of the United States District Court for the Southern District of New York.*

Opinions Below.

The opinion of the United States Court of Appeals for the Second Circuit (Appendix B**) was filed on July

* This petition is not directed to the "consolida[illegible]turn" issue on which the Court of Appeals affirmed the Dis[illegible] Court and no further reference will be made to such issue herein.

** The appendices hereto will be referred to as "App.".

30, 1962, and is officially reported at 306 F. 2d 824. The opinion of the United States District Court for the Southern District of New York (pp. 64a-131a of the Joint Appendix* in the Court below) was filed on November 8, 1961, and is officially reported at 199 F. Supp. 452.

Jurisdiction.

The judgment of the Court of Appeals (App. C) was entered on July 30, 1962. The jurisdiction of this Court is invoked under 28 U. S. C. §§1254(1) and 2101(c).

Question Presented.

Whether the term "dividends" as used in §902(a)** is intended to include *liquidating* dividends,*** so as to entitle a domestic corporation to a foreign tax credit for Canadian income taxes paid by a wholly-owned Canadian subsidiary corporation with respect to accumulated earnings and profits which were distributed to the domestic parent as a liquidating dividend.

Statutes and Treaty Involved.

§§316(a), 331(a), 901(a), 901(b)(1), 902(a), 902(b) and 904(a) of the 1954 Code are involved and are set forth in App. A at pp. 1-3. Articles XI and XV of the Income Tax

---

* The Joint Appendix in the Court below, nine copies of which were filed herewith, will be referred to as "Jt. App.".

** The section sign ("§") will be used with numerical references to designate sections of the Internal Revenue Code of 1954 (the "1954 Code"), unless otherwise indicated.

*** The term "liquidating dividends" is used herein to denote distributions in liquidation but only to the extent of earnings and profits accumulated after February 28, 1913,—thus excluding distributions from capital or paid-in surplus.

Convention between the United States and Canada (the "Treaty") and paragraph 7(c)* of the Protocol thereto are also involved and are set forth in App. A at pp. 4-5.

Statement.

There is no dispute as to the facts all of which were stipulated by the parties (Jt. App. 42a-50a). The pertinent facts with respect to the question presented may be summarized as follows:

Petitioner's wholly-owned subsidiary Automatic Electric Company ("Automatic"), a Delaware corporation, with which petitioner filed a consolidated income tax return for the year 1954 (the taxable year involved herein), owned all of the outstanding stock of Filcrest Company Ltd. ("Filcrest"), a Canadian corporation which was liquidated in 1954. In the course of such liquidation, Automatic received a liquidating distribution from Filcrest in 1954 in the amount of $9,574,386.10 which included $6,322,088.64 of earnings and profits accumulated by Filcrest from Canadian sources subsequent to February, 1913 and with respect to which Filcrest has paid Canadian income taxes in the amount of $2,387,564.86. The gain realized by Automatic on the liquidation of Filcrest ($5,069,868.67) was reported on petitioner's 1954 Federal income tax return as a long-term capital gain. (Jt. App. 43a-45a.)

The distribution was treated as a "dividend" by Canada within the meaning of Article XI.2 of the Treaty, and was subjected to a 5% dividend withholding tax by the Canadian authorities. On its 1954 income tax return, petitioner likewise treated the portion of the distribution representing earnings and profits accumulated by Filcrest since

* Now paragraph 6(c).

February, 1913 as a "dividend" for purposes of §902(a)* and claimed a foreign tax credit under §901(a)* (as limited by §904(a))* for (i) the $2,387,564.86 of Canadian income taxes paid by Filcrest with respect to such accumulated earnings and profits and (ii) the Canadian 5% tax which was withheld from Automatic. (Jt. App. 45a-46a.)

The District Director of Internal Revenue allowed petitioner the credit as claimed for the 5% withholding tax paid to Canada, but denied petitioner any credit for the Canadian income taxes previously paid by Filcrest with respect to its accumulated earnings and profits on the ground that §902(a) is not applicable with respect to *liquidating* dividends. After payment of the deficiency asserted by the District Director, petitioner duly filed a claim for refund of the deficiency so paid. Upon rejection of such claim for refund by the District Director, petitioner sued for refund in the United States District Court for the Southern District of New York. The jurisdiction of the District Court was invoked under 28 U. S. C. §1346.

The District Court held that the liquidating dividend received by Automatic from Filcrest constituted a "dividend" within the meaning of §902(a), and that accordingly petitioner was entitled to the deemed paid credit for

---

* Briefly, §§901(a) and 901(b)(1) allow United States taxpayers a credit (the "direct credit") for foreign income taxes paid directly by them. Under §902(a) a domestic corporation receiving a dividend from a foreign subsidiary is deemed to have paid the foreign income taxes previously paid by such subsidiary with respect to the accumulated profits distributed by such dividend,—thus entitling the domestic parent to a credit (the "deemed paid credit") for such foreign taxes under §901(a). §904(a) provides the only limitation on the amount of credit allowable under such sections, *viz.*, it prohibits the *aggregate* credit for taxes paid to any foreign country from exceeding an amount determined by applying the *overall* effective United States tax rate to the income from such foreign country.

Canadian income taxes paid by Filcrest with respect to the accumulated earnings and profits distributed to Automatic. In so holding, the District Court relied on (a) the *express statutory language* of §316(a)—defining the term "dividend" for the purpose of the entire income tax subtitle as including *any* distribution of earnings and profits accumulated after February 28, 1913 (Jt. App. 85a-90a, 106a-108a), (b) the fact that such literal construction effectuated the purpose of the foreign tax credit provisions to eliminate double taxation (Jt. App. 95a-96a, 102a), (c) the fact that this construction was in accord with the interpretation of other sections (including §§901(a), 902(b) and 904(a)) with which §902(a) is clearly in *pari materia* (Jt. App. 95a-96a, 97a-101a), and (d) the legislative history of the pertinent sections of the 1954 Code (Jt. App. 102a-106a).

The Court of Appeals below, reversing the judgment of the District Court, held that the foreign tax credit claimed by petitioner was not allowable. In so holding, the Court of Appeals rejected the arguments of both the petitioner and the respondent (App. B 6-16); appeared to disregard the clear language of the applicable statutory sections considered by the District Court; and, recognizing that there was no support for its decision either in the statute or the applicable legislative history, based its holding solely on a comparison of foreign tax rates and United States capital gains rates on liquidating dividends (App. B 17-18) and alleged possibilities of tax avoidance (App. B 18).* The Court of Appeals recognized that its decision

---

* The Court of Claims in *Freeport Sulphur Co.* v. *U. S.*, 163 F. Supp. 648 (1958) and the Court of Appeals for the Seventh Circuit in *Fowler Hosiery Co., Inc.* v. *Comm'r.*, 301 F. 2d 394 (1962), also held that liquidating dividends do not qualify as "dividends" under §902(a). Though the reasoning by which such courts reached this result differed in each case, their decisions were also largely predicated upon a comparison of foreign and U. S. tax rates on

resulted in double taxation, and was inconsistent with the application of other sections of the statute, in particular §904(a).*

Reasons for Granting the Writ.

I.

The Decision Below Conflicts with Rules Enunciated by This Court with Respect to the Meaning and Application of §316(a) and the Interpretation of §902(a) of the Internal Revenue Code of 1954.

The sole question presented is whether a liquidating dividend from a foreign subsidiary constitutes a "dividend" within the meaning of §902(a) so as to entitle the recipient of such distribution to a deemed paid credit for foreign income taxes paid by the foreign subsidiary with respect to the accumulated profits included in such distribution. There is no specific definition of "dividend" in §902 or in any of the other foreign tax credit provisions. However, there is a clearly expressed definition of "dividend" in §316(a), applicable to the entire income tax subtitle, including the foreign tax credit provisions.

---

particular items of income and hypothetical possibilities of tax avoidance.

Previously, in the only article treating the specific issue in detail, the author concluded that liquidating dividends qualified as dividends for the purpose of §902(a). Beauregard, *Distributions in Liquidation as Dividends in the Foreign Affiliate Tax Credit of the 1954 Code*, 41 Virginia L. Rev. 731 (1955). The District Court in its decision below cited this article with approval (Jt. App. 107a).

* This is clear from its references in the last paragraph of its opinion (App. B 18-19) to Rev. Rul. 54-15, 1954-1 Cum. Bull. 129 and *Helvering* v. *Campbell*, 139 F. 2d 865, 870 (4th Cir., 1944) which hold that subject to the limitation of §904(a), a taxpayer may receive full credit for foreign "ordinary income" taxes on income taxable in the United States at lower capital gains rates.

A. Conflict of the decision below with the rule of this Court in *Comm'r.* v. *Est. of Bedford*, 325 U. S. 283 (1945): The general definition of "dividend" in §316(a) by its clear terms is applicable to the entire income tax subtitle.

Insofar as here material, §316(a) provides clearly and without qualification as follows:

> "*For purposes of this subtitle*, the term 'dividend' means *any* distribution of property made by a corporation to its shareholders—(1) out of its earnings and profits accumulated after February 28, 1913 . . ." (Emphasis added.)

On the basis of §316(a), it is clear that *any* distribution of such earnings and profits (including a liquidating dividend) qualifies as a "dividend" for the purpose of §902(a). However, the Court below did not discuss the effect of §316(a) upon the interpretation of §902(a).

Comm'r. v. *Est. of Bedford*, 325 U. S. 283 (1945), involved the tax consequences of an exchange of stock for cash and other stock which constituted a corporate "reorganization" as well as a "partial liquidation". This Court held that the exchange treatment for complete and partial liquidations (now §331(a)*) was "limited" in scope, and could not be carried over to restrict the meaning of "dividends" in the "reorganization" provisions, which operate independently of the "exchange" treatment provided for

---

* Section 331(a) provides as follows:

"(a) GENERAL RULE—

(1) COMPLETE LIQUIDATION.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

(2) PARTIAL LIQUIDATIONS.—Amounts distributed in partial liquidation of a corporation (as defined in section 346) shall be treated as in part or full payment in exchange for the stock."

liquidations. This Court further held that the general definition of "dividend" (now contained in §316(a)) is *not* so limited but defines "dividend" for the purpose of the whole income tax title, and such definition is therefore "infused" into the reorganization provisions. See 325 U. S. at 291-292.

As in the case of the "reorganization" provisions involved in the *Bedford* case, the foreign tax credit provisions of the income tax subtitle of the 1954 Code (Subpart A of Part III of Subchapter N of Chapter 1) are in an independent subpart of the 1954 Code. Under the rule in the *Bedford* case, therefore, the broad statutory definition of the term "dividend" in §316(a) must be regarded as "infused" into §902(a) of the foreign tax credit subpart; and the decision of the Court of Appeals below is clearly in conflict with the rule of this Court as enunciated in that case.*

B. Conflict of the decision below with the rule of this Court in *American Chicle Co.* v. *U. S.*, 316 U. S. 450 (1942): §902(a) should be interpreted as written to avoid double taxation.

The *American Chicle* case is the only decision of this Court interpreting the language in §902(a). With respect to its predecessor sections, this Court stated that their purpose is to *"avoid double taxation"*, that *"the statute, as written, accomplishes that result"*** and relied on "the

---

* This analysis is supported by the legislative history of §902(a), discussed herein at pp. 18-19, *infra*.

** That the purpose of the deemed paid credit provision is to avoid double taxation is clear from the legislative history of the original predecessor of §902(a), *viz.*, §238(c) of the Revenue Act of 1921, c. 136, 42 Stat. 227 (the "1921 Act"). See 61 Cong. Rec. 7184 (1921).

The literal construction of the statute urged by petitioner herein is the only one which accomplishes the result of avoiding double taxation.

plain terms of the Act." 316 U. S. at 452, 453. (Emphasis added.)

Although the Court below recognized that its decision resulted in double taxation (App. B 18), it nevertheless refused to allow the deemed paid credit with respect to liquidating dividends. It reached such result solely because such distributions were then taxable in the United States at capital gains rates which it assumed were generally lower than the foreign tax rates on earnings of foreign subsidiaries,—and without regard to the purposes of §902(a). Thus, its decision is in conflict with the rule of this Court in the *American Chicle* case that the *foreign tax credit provisions, and §902(a) in particular, should be construed in such a way as to avoid double taxation.*

II.

The Decision Below Conflicts with Rules Enunciated by This Court in *Bingham Tr.* v. *Comm'r.*, 325 U. S. 365 (1945) and *Merrill* v. *Fahs*, 324 U. S. 308 (1945): Clearly Related Sections of Tax Statutes Should Be Construed in *Pari Materia.*

A. §902(a) is clearly related to §§901(a) and 904(a) and should have been construed in *pari materia* therewith by the Court below.

Neither the Court below, nor the courts in *Freeport Sulphur Co.* v. *U. S.*, 163 F. Supp. 648 (Ct. Cl. 1958) and *Fowler Hosiery Co., Inc.* v. *Comm'r.*, 301 F. 2d 394 (7th Cir. 1962), in their concern with differences between foreign tax rates and United States tax rates on the items of income in question, recognized the significance of §904(a) which applies to both the direct credit and the deemed paid credit and was intended by the Congress as the *only* limi-

tation designed to take care of any disparity between foreign tax rates and United States tax rates.

For the year 1954, §904(a) provided a "per-country" limitation on the amount of the foreign tax credit otherwise allowable. Under such per-country limitation, the amount of the foreign tax credit (whether direct or deemed paid) which may be claimed by a taxpayer with respect to any foreign country "shall not exceed the same proportion of the tax against which such credit is taken [i.e., the United States income tax] which the taxpayer's taxable income from sources within such country . . . bears to his entire taxable income for the same taxable year." §904(a) is obviously closely related to and in *pari materia* with the deemed paid credit computed under §902(a) as well as the direct credit computed under §901(b)(1).

The application of the §904(a) limitation has been well established for many years. It has been repeatedly held by the courts as well as the Internal Revenue Service that the §904(a) limitation is to be applied according to its clear and express terms, and as the only limitation intended by the Congress with respect to foreign tax credits. *Helvering* v. *Campbell*, 139 F. 2d 865 (4th Cir. 1944); *I. B. Dexter*, 47 B. T. A. 285 (1942), Acquiescence 1948-2 Cum. Bull. 1; *James H. Brace*, 11 T. C. M. 906 (1952); Rev. Rul. 54-15, 1954-1 Cum. Bull. 129. The "per country" limitation in §904(a) requires only a comparison of the *overall effective* tax rate of the foreign country involved with the *overall effective* United States tax rate as applied to the foreign source income. It prevents the credit for foreign taxes from exceeding the *overall effective* United States tax rate as applied to the foreign income involved. And, to the extent that a taxpayer has income taxable under the United States law at capital gains rates, the overall effective United States tax rate (as well as the limitation) is auto-

matically and correspondingly reduced below the rate applicable to ordinary income items. There is nothing in §904(a) suggesting that Congress intended to *eliminate* a credit for items taxed as ordinary income abroad merely because they are taxed in the United States at capital gains rates; and the *Campbell, Dexter,* and *Brace* cases, *supra,* as well as Rev. Rul. 54-15, *supra,* demonstrate that the Congress did not intend* to *disallow* a credit merely because *a particular item* of foreign income has been subjected to a higher foreign tax rate than the United States rate specifically applicable with respect thereto.

The Court below acknowledged this established interpretation of §904(a) (App. B 18-19), as it was obliged to do under the "legislative reenactment" rule of statutory construction enunciated by this Court (and followed by the District Court below, Jt. App. 99a-101a). But, instead of taking such established interpretation of the §904(a) limitation into account in interpreting §902(a) in accordance with the *pari materia* rule enunciated by this Court in the *Bingham* and *Merrill* cases, *supra,* the Court below proceeded to construe §902(a) without regard to §904(a); and purported to justify such action with the statement that "the Internal Revenue Code is not a high precision instrument" (App. B 19).

B. §902(a) is clearly related to §902(b), and should have been construed in *pari materia* therewith by the Court below.

As the District Court indicated in its opinion below (Jt. App. 95a-96a), §902(b) is of significance in the interpretation of the term "dividends" as used in §902(a).

* The reenactment of §904(a) in 1954 after the *Campbell, Dexter* and *Brace* decisions and Rev. Rul. 54-15 *supra,* constitutes Congressional approval of such interpretation of §904(a) under the principles set forth by this Court in *Cammarano* v. *U. S.*, 358 U. S. 498 (1959) and *Helvering* v. *Winmill,* 305 U. S. 79 (1938).

§902(b) extends the scheme of §902(a) by providing a deemed paid credit for foreign income taxes paid on the earnings of a foreign subsidiary (S-2) of a foreign subsidiary (S-1) where the earnings of S-2 are distributed to S-1 as a "dividend", and in turn distributed by S-1 to its domestic parent as a "dividend". In the case of both §§902(a) and 902(b), the criterion for the credit is the *remittance* of the earnings in question by way of "dividends" to the domestic parent. Since the dividends from S-2 to S-1 are not taxable at all under United States law, the question whether such dividends are liquidating dividends or ordinary dividends is completely immaterial. For example: Assume a case in which S-2 is liquidated into S-1 and earnings of S-2 on which a foreign income tax has been paid are distributed to S-1 on such liquidation. If such earnings and profits are in turn remitted by S-1 to its domestic parent as a "dividend", it is obvious (as the Court below seemed to acknowledge) that the Congressional purposes underlying §902(b) would be best effectuated by the allowance of a deemed paid credit for the foreign taxes previously paid by S-2.

Here again, under the well-established rule of construction enunciated by this Court in *Bingham Tr.* v. *Comm'r.*, 325 U. S. 365 (1945) and *Merrill* v. *Fahs*, 324 U. S. 308 (1945), two subsections as closely related as §§902(a) and 902(b) must be considered in *pari materia*, and any doubt as to the meaning of the term "dividends" in §902(a) should have been resolved in conformity with the meaning Congress must *necessarily* have intended for the term "dividends" in §902(b)—particularly when such meaning serves the admitted purposes of both sections, *viz.*, the elimination of double taxation. In complete disregard of such rule of construction, the Court below, in effect, treated §902(b) as irrelevant.

C. The foreign tax credit provisions of the 1954 Code (including §902(a)) are closely related in purpose to the Income Tax Convention between the United States and Canada and should have been considered in *pari materia* therewith by the Court below.

The Court below in footnote 2 of its opinion (App. B 4) stated:

> "The Commissioner allowed the $283,396.13 credit claimed by the taxpayer for the 5% Canadian dividend withholding tax paid on the liquidating distribution. It is not involved in the present litigation *except as it may throw light on the foreign tax credit claimed by Associated but disallowed by the Commissioner.*" (Emphasis added.)

The liquidating dividend in question was treated as a "dividend" by Canada within the meaning of Article XI.2 of the Treaty. Paragraph 7(c) of the Treaty Protocol and §7.31(b) of the United States Treasury Department Regulations interpreting the Treaty* both define the term "dividends" for purposes of the Treaty to include "all distributions of the earnings or profits of corporations"; and neither contains an exception for liquidating dividends. It was by virtue of such definition in the Treaty that Canada was limited, for the year in question, to the 5% dividend withholding tax on the liquidating dividend in issue herein.

If the liquidating dividend in question must be regarded by Canada as a "dividend" within the meaning of Article XI of the Treaty, it would seem appropriate and in line with the established doctrine of mutuality and reciprocity under such treaties similarly to treat the distribution as a "dividend" for purposes of §902(a).

While Article XV (which allows credit for Canadian taxes "in accordance with the provisions of the United States Internal Revenue Code") may prevent such defini-

* T. D. 5206, 1943-1 Cum. Bull. 526, 539.

tions from *controlling* the issue presented here (without regard to the 1954 Code),* it is submitted that the Treaty (designed as it is to eliminate double taxation on a mutually reciprocal basis and to harmonize the taxation principles of the two countries) must also be considered in *pari materia* with §902(a). As indicated, the Court below did refer to the 5% Canadian dividend withholding tax paid on the liquidating distribution, and the possibility of it throwing "light" on this question, but failed to give any consideration to the effect of the Treaty on the interpretation of §902(a), in conformity with the *ratio decidendi* of *Bingham Tr.* v. *Comm'r.*, 325 U. S. 365 (1945) and *Merrill* v. *Fahs*, 324 U. S. 308 (1945).

III.

The Decision Below Conflicts with the Rule Enunciated by this Court That Courts May Not Add to or Alter Statutory Language.

A. Conflict of the decision below with the principles enunciated by this Court in *Hanover Bk.* v. *U. S.*, 369 U. S. 672 (1962) and *Lewyt Corp.* v. *Comm'r.*, 349 U. S. 237 (1955): Courts may not, by judicial legislation, deny benefits of which they disapprove.

Contrary to the mandates repeatedly expressed by this Court, the Court below, as well as the courts in *Freeport Sulphur Co.* v. *U. S.*, 163 F. Supp. 648 (Ct. Cl. 1958) and *Fowler Hosiery Co., Inc.* v. *Comm'r.*, 301 F. 2d 394 (7th Cir.

---

* Article XVII of the Treaty reserves to the United States the right to include in the basis upon which its taxes are imposed all items of income of its citizens, residents and corporations as though the Treaty had not been adopted; but to the extent that such Article is relevant, it merely duplicates the Code reference in Article XV. Cf. §7852(d) which provides that no provisions of the 1954 Code shall be applied in a manner inconsistent with any treaty obligation of the United States.

1962), in effect, changed (or at least read additional language into) the statutory language to effectuate a result of which they approved, rather than leaving changes in the statute to the Congress.

In the *Hanover Bk.* case, *supra*, this Court stated with reference to the interpretation of a tax statute:

> ". . . Under such circumstances we are not at liberty, notwithstanding the apparent tax-saving windfall bestowed upon taxpayers, to add to or alter the words employed to effect a purpose which does not appear on the face of the statute. • • • Nevertheless, the Government now urges this Court to do what the legislative branch of the Government failed or elected not to do. This, of course, is not within our province.[23]

> "[23] We believe the Court of Appeals for the First Circuit was correct when it said in *Fabreeka Products Co.* v. *Commissioner*, 294 F. 2d 879: 'Granting the government's proposition that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the Congressional thumb, not the court's.' See also *Evans* v. *Dudley*, 295 F. 2d 713, 715, where the Third Circuit quotes this language from Judge Aldrich's opinion in *Fabreeka Products*." 369 U. S. at 687-688.

And in the *Lewyt* case, *supra*, this Court stated:

> ". . . But where the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer though they represent an unexpected windfall." 349 U. S. at 240.

The benefits petitioner seeks are "fairly within the statutory language." Filcrest's liquidating dividend falls squarely within the statutory definition of "dividend" prescribed in §316(a) for purposes of the entire income tax

subtitle of the 1954 Code. Petitioner's construction of §902(a) is also "in harmony with the statute as an organic whole" when proper consideration is given to the various provisions of the 1954 Code and the Treaty which are clearly in *pari materia* with such section.

The Court below, however, rather than addressing itself to the language and scheme of the sections granting and limiting the foreign tax credit or to their primary purpose of avoiding double taxation, concerned itself mainly with the assumptions that (i) foreign tax rates on ordinary income are generally higher than the United States capital gains rate (App. B 17), and (ii) an allowance of the credit in this case "would facilitate a convenient scheme for avoiding the United States income tax." (App. B 18) The Court refers to the possibility that a domestic corporation could set up one or more foreign subsidiaries for the purpose of accumulating earnings and then liquidate such subsidiaries at capital gains rates to secure the benefits of the foreign tax credit against other income. However, any such tax avoidance schemes would clearly come within the prohibition of §269 which would deny a taxpayer a tax credit with respect to a corporation control of which is acquired for the principal purpose of evasion or avoidance of Federal income taxes. There is absolutely nothing in the record of this case to indicate that Filcrest was organized or liquidated for tax avoidance purposes, nor has respondent ever made any such suggestion. Moreover, the Court below—in its assumption that taxpayers would be encouraged to set up foreign corporations and liquidate such corporations for the purpose of obtaining the deemed paid credit—disregarded the economic realities of business investments in foreign countries which involve substantial amounts of money and effort as well as risks of fluctuating currency exchange rates, blocked currency and expropriation.

The Court's assumption that petitioner had a choice to pay out the earned surplus of Filcrest as ordinary dividends is without merit. This is precisely what the taxpayer attempted to do in *Fowler Hosiery Co., Inc.* v. *Comm'r.*, 301 F. 2d 394 (7th Cir. 1962)—but without success. It is a well established principle of law that once a decision has been made to liquidate a corporation, all subsequent distributions by such corporation in pursuance of that decision will be treated as *liquidating distributions*, even though cast *in the form of ordinary* dividends. Merten's, *Law of Federal Income Taxation* (Zimet, Stanley & Kilcullen Revision, 1962), Vol. I, §9.79. In any event, petitioner respectfully submits that what could or could not have been done by petitioner as an alternate course of procedure is hardly a valid reason for not applying the statute as written,—particularly when the statute as written effectuates the principal purpose of the foreign tax credit provisions of the law, *viz.*, the elimination of double taxation.

B. Conflict of the decision below with the rule of this Court in *Helvering* v. *Bliss*, 293 U. S. 144 (1934) and *U. S.* v. *Pleasants*, 305 U. S. 357 (1939): One statutory provision granting tax relief is not modified by another provision granting tax relief, unless required by specific statutory language.

In the *Bliss* case the Commissioner of Internal Revenue contended, in effect, that the enactment of capital gains relief for individual taxpayers had the effect of reducing the charitable deduction which would otherwise have been allowable to such taxpayers. In holding against the Commissioner, this Court stated:

> "The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are

> not to be narrowly construed. Nor should the reduction in the rate of tax on capital gain, first granted in the Revenue Act of 1921, be held to circumscribe the privilege granted in the earlier Acts, and retained in later ones, with respect to charitable contributions, unless that result be plainly required by the language used." 293 U. S. at 150-151.

This same rule of statutory construction was reiterated by this Court in the *Pleasants* case; and was expressly followed by the District Court below in the instant case. (Jt. App. 82a-83a, 93a).

The original predecessor of §902(a) was enacted in substantially its present form as §238(e) of the 1921 Act.* Under §201(a) of such Act (now §316(a)), liquidating dividends were treated the same as ordinary dividends; and it is clear that the deemed paid credit provisions of such Act applied to liquidating dividends as well as ordinary dividends. Primarily with a view to providing "capital gains" relief to *individual* taxpayers in 1924, the Congress provided in §201(c) of the Revenue Act of 1924, c. 234, 43 Stat. 253 (the "1924 Act") that liquidating distributions should be treated as amounts received "in full payment in exchange for the stock". While this "exchange" treatment for liquidating distributions (now §331(a)) has continued to date,** *corporate* taxpayers did not become entitled to any

---

* *American Chicle Co.* v. *U. S.*, 316 U. S. 450 (1942); Hearings on Revenue Revision before the House Committee on Ways and Means, 81st Cong., 2d Sess. 275 (1950); Jt. App. 79a.

** It was Respondent's principal argument in the Court below (as well as in the *Freeport* and *Fowler* cases, *supra*) that the "exchange" treatment enacted for corporate liquidations in the 1924 Act (and continued to date) had the effect of removing liquidating dividends from the meaning of the term "dividend" wherever used in the income tax law. However, this position was expressly rejected by the Court below (App. B 15-16). And, from the courts' opinions in the *Freeport* and *Fowler* cases, it is obvious that the position was equally unacceptable to them.

capital gains relief on such distributions until the enactment of the Revenue Act of 1942.* Such capital gains relief has continued to date for both corporate and individual taxpayers. But, as the District Court below found, there is nothing in the legislative history of either the 1924 Act or the 1942 Act or any subsequent revenue act indicating an intention on the part of the Congress through such enactment to curtail the deemed paid credit relief initiated for liquidating dividends in §238(e) of the 1921 Act (Jt. App. 93a, 106a).

As heretofore indicated (and in sharp contrast with the District Court's opinion herein), the decision of the Court below was based entirely upon the reduced tax rate now applicable with respect to long-term capital gains from corporate liquidations; and it is reasonably clear from the Court's opinion that its decision would have gone the other way had petitioner been required (as under pre-1942 law) to include the capital gain from Filcrest's liquidation as *ordinary* income.

In effect, therefore, the Court below, without any basis whatever in the statutory language or the applicable legislative history, interpreted the capital gains relief initiated for corporations generally in 1942, now provided by §331(a) (in conjunction with §§1201(a), 1221 and 1222), as adversely affecting the foreign tax credit relief provisions (§§901, 902, 904) which have been in the law since 1921. Such a holding is in direct conflict with the above described

---

* §150(c) of the Revenue Act of 1942, c. 619, 56 Stat. 798 (the "1942 Act"), amending §117(c) of the Internal Revenue Code of 1939 (now §1201(a)), extended to *corporations* generally the same ceiling rate (25%) on long-term capital gains which was previously provided for *individual* taxpayers.

rule of this Court as enunciated in the *Bliss* and *Pleasants* cases, *supra.**

IV.

The Question Presented Is of Fundamental and Continuing Importance to the Interpretation and Administration of the Foreign Tax Credit Provisions of the 1954 Code.

The applicability of the deemed paid credit may arise every time a domestic corporation partially or completely liquidates a foreign subsidiary which has paid income taxes to a foreign country. The possibility of continuing litigation of this question is heightened since the decision of the Court below, as well as the decisions of the Court of Claims and the Court of Appeals for the Seventh Circuit on this issue, were predicated upon a gratuitous comparison of the tax rates of the foreign country in question and the United States tax rate on the specific item of income. It is a matter of note that the Court of Claims in the *Freeport* case, *supra,* seemed influenced by the fact that the foreign tax rate in that case was *lower* than the applicable United States capital gain rate. On the other hand, the Seventh Circuit in the *Fowler* case, *supra,* and the Second Circuit in this case were influenced by the assumption that foreign tax rates were generally *higher* than the United States capital gains tax rates.**

---

*Although this Court affirmed the court below in the *Bliss* case, it is noted that the writ of certiorari was granted therein notwithstanding the unanimity of opinion in the courts below (*viz.*, the United States Courts of Appeal for the First and Second Circuits and the United States District Court for the Northern District of Illinois) with respect to the question presented.

** See the pointed criticism of the decision of the Court below in 11 *U. S. Tax Week,* No. 33 (published by Fallon Law Book Co., Inc.), August 17, 1962, at pp. 1407 ff.

The effect of the decision of the Court below, as well as those of the Court of Claims in *Freeport* and the Seventh Circuit in *Fowler*, concededly is serious double taxation, and may substantially affect the decisions of United States business with respect to investments abroad. This is particularly true in respect of those foreign countries where changes in the political climate may require United States taxpayers to liquidate their corporate investments therein. Under the decision of the Court below, when such a liquidation takes place, a domestic corporate taxpayer will be subject to double taxation since it may well be liable for a United States income tax but will not secure a foreign tax credit for income taxes already paid by the foreign subsidiary to the foreign country. Petitioner respectfully submits that under the language of the present statute, the Congress intended that such double taxation be prevented by §§901 and 902 and the income tax treaties with Canada and other foreign countries.

The question presented herein is obviously a fundamental one, of great importance to the administration of the tax laws and with serious and far-reaching consequences to the transaction of United States business abroad and should be finally settled by this Court.*

---

* Compare *Cammarano* v. *U. S.*, 358 U. S. 498 (1959) in which this Court granted certiorari on taxpayers' petitions from the decisions of the Courts of Appeal for the Eighth and Ninth Circuits, both of which reached the same results, "because of the recurring nature of the question, and because of its importance to the proper administration of the Internal Revenue laws."

Conclusion.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

JOHN J. BOLAND,
WINTHROP, STIMSON, PUTNAM & ROBERTS
40 Wall Street
New York 5, N. Y.
Attorney for Petitioner

Of Counsel:

THEODORE F. BROPHY
ROBERT ADELSON
730 Third Avenue
New York, N. Y.

ROBERT P. ADELMAN
40 Wall Street
New York, N. Y.

October 24, 1962.

APPENDIX A.

Statutes and Treaty Involved.

Internal Revenue Code of 1954 (as in effect for the year 1954):

SEC. 316. DIVIDEND DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

SEC. 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS.

(a) GENERAL RULE.—

(1) COMPLETE LIQUIDATIONS.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

(2) PARTIAL LIQUIDATIONS.—Amounts distributed in partial liquidation of a corporation (as defined in section 346) shall be treated as in part or full payment in exchange for the stock.

SEC. 901. TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES.

(a) ALLOWANCE OF CREDIT.—If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under section 902. Such choice may be made or changed at any time prior to the expiration of the period prescribed for making a claim for credit or refund of the tax against which the credit is allowable. The credit shall not be allowed against the tax imposed by section 531 (relating to the tax on accumulated earnings), against the additional tax imposed for the taxable year under section 1333 (relating to war loss recoveries), or against the personal holding company tax imposed by section 541.

(b) AMOUNT ALLOWED.—Subject to the applicable limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) CITIZENS AND DOMESTIC CORPORATIONS.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States . . .

SEC. 902. CREDIT FOR CORPORATE STOCKHOLDER IN FOREIGN CORPORATION.

(a) TREATMENT OF TAXES PAID BY FOREIGN CORPORATION.—For purposes of this subpart, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits.

(b) FOREIGN SUBSIDIARY OF FOREIGN CORPORATION.—If such foreign corporation owns 50 percent or more of the voting stock of another foreign corporation from which it receives dividends in any taxable year, it shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid by such other foreign corporation to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of the corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits.

SEC. 904. LIMITATION ON CREDIT.

"(a) LIMITATION.—The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year."

Income Tax Convention Between the United States and Canada (as in effect for the year 1954):

ARTICLE XI.

1. The rate of income tax imposed by one of the contracting States, in respect of income derived from sources therein, upon individuals residing in, or corporations organized under the laws of, the other contracting State, and not having a permanent establishment in the former State, shall not exceed fifteen per cent for each taxable year.

2. Notwithstanding the provisions of paragraph 1 of this Article, income tax in excess of five per cent shall not be imposed by one of the contracting States in respect of dividends paid by a subsidiary corporation organized under the laws of such State, or of a political subdivision thereof, to a parent corporation organized under the laws of the other contracting State, or of a political subdivision thereof: Provided, however, That this paragraph shall not apply if the competent authority in the former State is satisfied that the corporate relationship between the two corporations has been arranged or is maintained primarily with the intention of taking advantage of this paragraph.

ARTICLE XV.

As far as may be in accordance with the provisions of The Income Tax Act, Canada agrees to allow as a deduction from the Dominion income and excess profits taxes on any income which was derived from sources within the United States of America and was there taxed, the appropriate amount of such taxes paid to the United States of America.

As far as may be in accordance with the provisions of the United States Internal Revenue Code, the United States of America agrees to allow as a deduction from the income and excess profits taxes imposed by the United States of

America the appropriate amount of such taxes paid to Canada.

PROTOCOL.

7. (c) The term "dividends", as used in this Convention, shall include all distributions of the earnings or profits of corporations.

APPENDIX B.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 333—September Term, 1961.

(Argued April 27, 1962 Decided July 30, 1962.)

Docket No. 27396

ASSOCIATED TELEPHONE AND TELEGRAPH COMPANY,
Appellant and Cross Appellee,

v.

UNITED STATES OF AMERICA,
Appellee and Cross Appellant.

Before:

WATERMAN, SMITH and MARSHALL,
Circuit Judges.

Appellant Associated Telephone and Telegraph Company brought suit in the United States District Court for the Southern District of New York claiming a refund due it for an alleged overpayment of its United States income taxes for its taxable year 1954. The appellant United States moved for summary judgment dismissing the complaint, and appellant taxpayer cross-moved for summary judgment on its part. The court below, Levet, *J.*, in a written opinion reported at 199 F. Supp. 452, granted the Government's motion as to one of taxpayer's claims for relief, the "consolidated loss issue." The court granted the taxpayer's cross-motion as to the other, the "foreign tax credit issue." Taxpayer appeals from the granting of

the Government's motion, and as to this appeal we affirm the court below on its opinion, 199 F. Supp. 452 at pp. 469-477. The Government appeals from the granting of taxpayer's cross-motion, and, as to this appeal, we reverse the judgment below and remand.

WINTHROP, STIMSON, PUTNAM & ROBERTS, by JOHN J. BOLAND, a member of the firm (THEODORE F. BROPHY, ROBERT ADELSON, ROBERT P. ADELMAN, of counsel), New York City, for Appellant.

ROBERT M. MORGENTHAU, U. S. Atty., S. D. N. Y. (ROBERT ARUM, Asst. U. S. Atty., HAROLD C. WILKENFELD, Atty., Dept. of Justice, of counsel), for Appellee.

WATERMAN, Circuit Judge:

This case presents two distinct questions of federal income taxation under the Internal Revenue Code of 1954, one involving the treatment of capital losses on a consolidated return, the other involving the foreign tax credit provisions. The taxpayer brought this action in the United States District Court for the Southern District of New York pursuant to 28 U. S. C. §1346, seeking a refund of a portion of the federal income taxes it had paid for the taxable year 1954. The district court in an opinion reported at 199 F. Supp. 452 (S. D. N. Y. 1961) granted summary judgment for the Government on the consolidated return issue and summary judgment for the taxpayer on the foreign tax credit issue. Each party appealed from the judgment against it. On the consolidated return issue we affirm on the able opinion of Judge Levet below, 199 F. Supp. at 469-77.

Thus we turn to a consideration of the foreign tax credit issue raised by the Government's appeal. The facts relevant to this issue were stipulated by both parties. They are as follows:

Appendix B.

The plaintiff taxpayer Associated Telephone and Telegraph Co. (Associated) is a Delaware corporation with its principal place of business in New York City. Associated has a wholly-owned subsidiary, Automatic Electric Co. (Automatic), also a Delaware corporation. Automatic formerly had two wholly-owned subsidiaries, Pan-American Telephone & Telegraph Company (Panco), a Delaware corporation, and Filcrest Co., Ltd. (Filcrest), which was organized and existed under the laws of Canada. All of these corporations were within the affiliated group of the plaintiff Associated.

In 1954 the directors and shareholder of Filcrest adopted resolutions providing for the liquidation of that corporation. On December 15, 1954, the Filcrest liquidator, appointed by the Supreme Court of Ontario, Canada, distributed assets having an aggregate fair market value of $9,574,386.10 to Filcrest's sole shareholder Automatic.[1] Out of this sum the liquidator paid $283,396.13 directly to the Director of Internal Revenue, Taxation Division, of the Dominion of Canada, to satisfy the 5% dividend withholding tax imposed by the Canadian Income Tax Act and in accord with Article XI.2 of the Income Tax Convention between the United States and Canada.

For the taxable year 1954 the plaintiff filed a consolidated United States income tax return, pursuant to the Internal Revenue Code of 1954 §§1501 and 6012(a), for itself and its subsidiary corporations, Automatic, Filcrest and Panco. The return disclosed consolidated taxable income in the amount of $14,969,808.42 and consolidated income tax liability in the amount of $5,189,174.48, which latter amount the plaintiff paid to the Delaware District Director of Internal Revenue.

The gain to Automatic on the distribution of Filcrest's assets, $5,069,868.67, was reported on the 1954 consolidated return as a long-term capital gain.

---

[1] All figures are expressed in American dollars.

Appendix B.

At the time of its liquidation distribution Filcrest had, for federal income tax purposes, accumulated earnings and profits after February 28, 1913, in the amount of $6,322,008.64. Upon these accumulated earnings and profits Filcrest had paid to the Dominion of Canada and the provinces of Quebec and Ontario income and excess profits taxes in the aggregate amount of $2,387,564.86. Treating Filcrest's liquidating distribution to Automatic as income received from a foreign source, the plaintiff on its 1954 United States consolidated return, to the extent of Filcrest's accumulated earnings and profits, treated the distribution as a "dividend" within the meaning of Int. Rev. Code of 1954 §902(a). Accordingly, the taxpayer claimed a foreign tax credit, pursuant to Int. Rev. Code of 1954 §§901, 902, and 904, for the Canadian taxes of $2,387,564.86 paid by Filcrest on its earnings and profits. This credit was claimed in addition to the credit claimed under §901 for the amount of the 5% Canadian dividend withholding tax paid there on the liquidating distribution.

The Commissioner of Internal Revenue disallowed the $2,387,564.86 foreign tax credit claimed by Associated for the Canadian taxes paid by Filcrest on its earnings and profits.[2] The taxpayer paid the ensuing deficiency and filed a claim for its refund. After the Commissioner disallowed the claim, Associated brought this action in the district court, where the judge below rejected the position taken by the Commissioner, and, accordingly, granted summary judgment for the taxpayer.

The sections of the 1954 Code which are primarily relevant here are §§901, 902(a) and 904(a). In brief, §901 of the Internal Revenue Code of 1954 authorizes a credit against one's federal income tax liability for like taxes paid

---

[2] The Commissioner allowed the $283,396.13 credit claimed by the taxpayer for the 5% Canadian dividend withholding tax paid on the liquidating distribution. It is not involved in the present litigation except as it may throw light on the foreign tax credit claimed by Associated but disallowed by the Commissioner.

to foreign countries.[3] Section 902(a) makes a foreign tax credit available to a domestic corporation in any taxable year in which the domestic corporation receives "dividends" from a foreign corporation for a proportionate share of the income taxes paid or deemed to have been paid by the foreign corporation to a foreign country on accumulated earnings and profits.[4] Section 904(a) limits the total credit to which the taxpayer is entitled for taxes paid to a particular foreign country to that proportion of the taxpayer's United States income tax which its taxable income from that foreign country bears to its entire taxable income

---

[3] Sec. 901. Taxes of Foreign Countries and of Possessions of United States.

(a) *Allowance of Credit.*—If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under section 902. • • •

(b) *Amount Allowed.*—Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) *Citizens and domestic corporations.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States. • • •

[4] Sec. 902. Credit for Corporate Stockholder in Foreign Corporation.

(a) *Treatment of Taxes Paid by Foreign Corporation.*—For purposes of this subpart, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits.

under the Internal Revenue Code for the same taxable year.[5]

The question we are called upon to decide is whether the term "dividends" in §902(a) includes liquidating distributions. If the term does not include liquidating distributions, the Commissioner was correct in disallowing the credit the taxpayer claimed it was permitted to take upon the liquidation of Filcrest.

Both the taxpayer and the Government seek to substantiate their respective positions by extensive analysis of successive revenue acts. A review of the history of the provisions relevant here is therefore appropriate.

The first act which allowed a credit to a domestic corporation for taxes paid by a foreign corporation in which the domestic corporation was a shareholder was the Revenue Act of 1918. As in all subsequent acts and codes, the credit was allowed at the time the domestic corporation received a "dividend" from the foreign corporation.[6] This type

---

[5] Sec. 904. Limitation on Credit.

(a) *Limitation.*—The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

[6] Revenue Act of 1918, Sec. 240. (c) For the purpose of section 238 a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be deemed to have paid the same proportion of any income, war-profits and excess-profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources without the United States which the amount of any dividends (not deductible under section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid: Provided, That in no such case shall the amount of the credit for such taxes exceed the amount of such

of foreign tax credit has often been referred to as the "deemed to have been paid" credit. In that revenue act, the two prior acts, and all subsequent acts and codes, the general definition of a dividend, without certain qualifications not relevant here, was "any distribution of property made by a corporation to its shareholders out of its earnings and profits accumulated after February 28, 1913."[7] In the 1918 Act liquidation distributions were treated as payments in exchange for stock.[8]

In the Revenue Act of 1921, Congress expanded the foreign tax credit provision so as to allow to a domestic corporation holding stock in a foreign corporation a credit for foreign taxes paid by the foreign corporation on its accumulated profits in years prior to the year in which the pertinent dividend was paid or was payable to the domestic corporation.[9] See *American Chicle Co.* v. *United States*,

---

dividends (not deductible under section 234) received by such domestic corporation during the taxable year.

Until the Revenue Act of 1951 the domestic corporation was required to own a majority of the voting stock of the foreign corporation to be entitled to a foreign tax credit under this provision. The Revenue Act of 1951, §322(a), reduced the ownership requirement to ten per cent of the foreign corporation's voting stock.

[7] Revenue Act of 1916, §2(a); Revenue Act of 1917, §1211; Revenue Act of 1918, §201(a); Revenue Act of 1921, §201(a); Revenue Act of 1924, §201(a); Revenue Act of 1926, §201(a); Revenue Act of 1928, §115(a); Int. Rev. Code of 1939, §115(a); Int. Rev. Code of 1954, §316(a).

[8] Revenue Act of 1918, Sec. 201(c).

[9] Revenue Act of 1921, Sec. 238. (e) For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234) in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits • • •

316 U. S. 450 (1942). Furthermore, in the 1921 Act the treatment of liquidating distributions as payments in exchange for corporate stock was removed; and liquidating distributions were to be treated like ordinary dividends. Treas. Reg. 62, art. 1545.

The 1924 Act did not change the foreign tax credit provisions involved here. However, it did reinstate exchange treatment for liquidating distributions.[10] The 1924 Act also began capital gain treatment for sales and exchanges of capital assets held by individual taxpayers, but not by corporations.[11]

In the Revenue Act of 1942, Congress for the first time extended capital gain treatment to corporations.[12]

The provisions outlined above became parts of the Internal Revenue Code of 1954 without significant change. See S. Rep. No. 1622, 83d Cong., 2d Sess. 419 (1954); H. R. Rep. No. 2543, 83d Cong., 2d Sess. 68 (1954). The foreign tax credit allowed to domestic corporations for foreign taxes paid by a foreign corporation or paid by the subsidiary of a foreign corporation is §902(a) of the 1954 Code. The general dividend provision is §316(a). The exchange treatment for corporate liquidations is found in §331(a).

On the basis of this history the Government argues that the original predecessor to the present §902(a) was the provision above referred to that appears in the Revenue Act of 1918, and that at that time distributions in liquidation were considered by Congress as payments in exchange for corporate stocks, not corporate dividends. Therefore, the Government argues that the 1918 Congress did not intend the term "dividend" in the "deemed to have been paid" foreign tax credit provision to include a distribution in liquidation. To support its position the Government

[10] Revenue Act of 1924, Sec. 201(c).

[11] Revenue Act of 1924, Sec. 208.

[12] Int. Rev. Code of 1939, Sec. 117(c)(1).

relies upon the Supreme Court's decision in *Hellmich* v. *Hellman*, 276 U. S. 233 (1928). That case involved the credit accorded an individual against the normal tax upon his net income for amounts "received as dividends." Revenue Act of 1918, §216(a). The court held that a distribution in liquidation was not a dividend so as to entitle recipients of such a distribution to the credit provided by §216(a). Cf. *Foster* v. *United States*, 303 U. S. 118 (1938). The Government also relies upon a comment of the House Ways and Means Committee in 1950:

> Even if the liquidation or merger of a foreign subsidiary corporation does not qualify as tax-free, the domestic parent corporation is taxed on its gain only at long-term capital gain rates, including that part of the gain which is attributable to earnings of the foreign subsidiary which have been accumulated free of United States income tax. *This procedure may not always be profitable, however, since a credit for foreign income taxes is not allowed against the capital gain tax.* (Emphasis added.) H. Rep. No. 2319, 81st Cong., 2d Sess. 52 (1950).

The taxpayer, on the other hand, asserts that, because of the substantial change in the foreign tax credit brought about by the 1921 Act, that act, instead of the 1918 one, was the true origin of the present provision. See Hearings on Revenue Revision Before the House Committee on Ways and Means, 81st Cong., 2d Sess. 275 (1950); *cf.* 5 Mertens, Federal Income Taxation §33.14 at n. 18 (Zimet & Ness Revision). Inasmuch as the 1921 Act treated distributions in liquidation as dividends, the taxpayer contends that the 1921 Congress intended "dividends" in the "deemed to have been paid" foreign tax credit provision to include a distribution in liquidation. The taxpayer further contends that the Revenue Acts of 1924 and 1942 in reestablishing exchange treatment for liquidation distributions and in extending capital gain treatment first to indi-

viduals and then to corporations could in no way affect the scope of the term "dividend" in the "deemed to have been paid" foreign tax credit provision.

We find neither the Government's nor the taxpayer's argument persuasive. When there is nothing to indicate that any of the draftsmen or legislators responsible for any of the provisions here involved ever considered the problem before us, it is pure fiction to conclude that, because Congress passed certain broad legislation dealing with liquidation distributions and capital gain treatment at various times and did not at other times, Congress must have "intended" certain results under the foreign tax credit provisions. This type of analysis imputes to the legislators an infinity of knowledge and a unity of intention which they obviously did not have. Such an analysis does little to throw light on the purposes behind the "deemed to have been paid" credit provision. The decision in *Hellmich* v. *Hellman, supra,* may be a helpful analogy because it involved a credit provision somewhat analogous to the one at issue here, but still it is relevant only as an analogy. If the comment by the House Committee, relied upon by the Government, had been made shortly after the original enactment of the foreign tax credit legislation on which the Committee was commenting, we might place great reliance on that statement. The Committee would then have likely been conversant with the purpose of the provision. See *Tri-Lakes S.S. Co.* v. *Commissioner,* 146 F. 2d 970 (6 Cir. 1945). But the "deemed to have been paid" foreign tax credit provision had been in the successive revenue acts for over twenty-five years when this particular comment was made. Accordingly, we are able to express our view of the significance of the 1950 comment by the House Committee by quoting from Judge Learned Hand:

> Congress may no doubt indicate its understanding as to the scope of its former words, and when this can be

> treated as a command, it will control, subject to constitutional limits [Merle-Smith v. Commissioner, 42 F. (2d) 837, 842 (C. C: A. 2)]; but its interpretation as such is immaterial. It is as likely to be wrong as anyone else, and in the end the courts must decide.
>
> *Fire Cos. Bldg. Corp.* v. *Commissioner*, 54 F. 2d 488, 489 (2 Cir. 1931), *cert. denied*, 286 U. S. 546 (1932).

See also *Penn Mutual Life Ins. Co.* v. *Lederer*, 252 U. S. 523, 538 (1920).

The parties also seek to support their respective positions by discussion of related and analogous provisions of the Internal Revenue Code of 1954. The plaintiff contends that Sections 861 and 862 substantiate the proposition that the term "dividends" in Section 902(a) includes liquidating dividends. Section 861 lists certain types of income which are to be treated as income from sources within the United States. Section 862 lists certain types of income that are to be treated as income from sources outside of the United States. Both sections refer to "dividends," §861(a)(2) and §862(a)(2); and neither section makes separate reference to liquidation distributions. Since the parties have stipulated that the distribution involved here is foreign source income, Associated maintains the distribution is includible within the category of "dividends" provided by §862(a)(2), and, if this is so, it must also come within the category of "dividends" in the closely related §902(a).

As the Government points out, however, the next following section, §863, makes it abundantly clear that §§861 and 862 were not intended to be comprehensive lists of all types of income. See Treas. Reg. §1.863-1(a). It would be an appropriate interpretation of the statutory scheme to treat liquidating distributions as "other" foreign source income under §863 instead of within one of the enumerated types

of income under §862. Cf. *Helvering* v. *Suffolk Co.*, 104 F. 2d 505 (4 Cir. 1939).

The taxpayer calls our attention to the Fourth Circuit decision of *Hay* v. *Commissioner*, 145 F. 2d 1001 (4 Cir. 1944), *cert. denied*, 324 U. S. 863 (1945). The taxpayer in that case, the sole shareholder of a California corporation, transferred all of his stock in the corporation to a newly created foreign personal holding company. Then he had the holding company liquidate the California corporation. Besides answering several other tax questions, the Fourth Circuit held that the distribution was income from a source within the United States. The court seemingly rested this part of its decision on the predecessor to §861(a)(2), for it said that that subsection encompassed liquidation distributions as well as ordinary dividends. The *Hay* decision was a desirable one, because it prevented a convenient tax avoidance scheme. It is obvious that the court in *Hay* did not have the present situation in mind. As we mentioned above, perhaps it would have been more suitable to classify distributions in liquidation as "other" income. In any event, we do not accept the implication which the taxpayer here asserts must follow from the *Hay* decision; namely, that we are required to interpret "dividends" in Section 902(a) as including liquidating distributions.

The taxpayer also finds assistance in §902(b). That subsection, first enacted in 1942,[13] allows a credit to a domestic corporation for foreign taxes paid by a foreign subsidiary (S-2) of the foreign corporation in which the domestic corporation holds stock directly (S-1). This subsection, like §902(a), ties its relief to the transmission of "dividends" between corporations. Since a distribution from (S-2 to S-1) is beyond the reach of the American taxing authorities, the taxpayer maintains that it should be irrelevant under Section 902(b) whether (S-2) distributes assets to (S-1) in the form of an ordinary dividend

[13] Int. Rev. Code of 1939, Sec. 131(f)(2).

or as a liquidation distribution. Perhaps this is true, but just because no Congressional tax policy would be frustrated by reading "dividend" in §902(b) so as to include liquidation distributions, it does not follow that a Congressional policy behind §902(a) would not be frustrated by interpreting the term "dividend" in this subsection to include liquidating distributions. If symmetry must be preserved throughout §902, it would seem more appropriate to let the scope of the word in subsection (a) determine the meaning of the same word in subsection (b) instead of attributing a meaning to the word in (b) and then attempting to relate that meaning back to the word in (a).

Associated relies on language in §583 and also upon the statutory pattern indicated by §§852(b)(3)(B) and 854(a). Section 583 allows a deduction to banking institutions for certain dividends paid by them to the United States or to any of its instrumentalities. The section explicitly excludes from the category of exempt dividends distributions in liquidation. Associated argues that this section demonstrates that Congress knew how to express itself when it desired to separate liquidation distributions from dividends; and, therefore, when there is no explicit differentiation (e.g., §902(b)), the term "dividend" should be interpreted to include liquidation distributions. The difficulty with this inference is that Congress also knew how to express itself when it specifically wanted liquidation distributions to be treated as dividends. See §562(b), which relates to the "dividends paid" deduction. Turning to §§852(b)(3)(B) and 854(a), the former provides capital gain treatment for certain dividends received by shareholders of regulated investment companies; and the latter provides that the recipients of such dividends are not entitled to certain benefits that are granted to shareholders who receive the usual type of dividend. These two sections relate to the treatment of distributions, presumably in the ordinary course of business, which are attributable to capital gains realized by an investment company on the

sale of its portfolio securities. Such provisions throw little light on the question whether liquidation distributions, which, in any event, receive capital gain treatment under the broader §331, are to be treated like ordinary dividends when one seeks to take advantage of the "deemed to have been paid" foreign tax credit.

The Government on the other hand, calls our attention to §243(a), which allows to corporations a "dividends received" deduction of eighty-five per cent on dividends received from domestic corporations. In *Robert Gage Coal Co.*, 2 T. C. 488 (1943), the Tax Court held that a predecessor to §243(a)[14] did not apply to liquidating distributions. See also 7 Mertens, Federal Income Taxation §38.44 (Zimet & Barton Revision). The Government contends that there is a "close conceptual relationship" between §243(a) and §902(a), and, therefore, the interpretation in the *Robert Gage Coal Co.* case should carry over to §902(a). But there is no indication that it was the purpose of Congress in passing §902(a) to treat the domestic corporate shareholder of a foreign corporation in the same way as the domestic corporate shareholder of a domestic corporation is treated. Therefore, we are not so sure that the Congressional policies underlying §243 and §902(a) are as closely related as the Government would have us believe.

The taxpayer retorts with two decisions, *Pembroke Realty & Sec. Corp.* v. *Commissioner*, 122 F. 2d 252 (2 Cir. 1941), and *Piper* v. *United States*, 50 F. Supp. 363 (D. Minn. 1943), *appeal dismissed*, 142 F. 2d 465 (8 Cir. 1944), involving the Revenue Act of 1934, §351, which imposed a surtax on the undistributed adjusted net income of personal holding companies. In determining undistributed adjusted net income "dividends paid during the taxable year" were to be excluded. §351(b)(2)(C). In *Pembroke* and *Piper* the courts applied this provision to liquidation distributions. See also *Fisher* v. *Kavanagh*, 100 F. Supp. 248

[14] Revenue Act of 1936, Sec. 26.

(E. D. Mich. 1951). But other courts have apparently disagreed with this interpretation of "dividends" paid by personal holding companies. *Brooklyn Nat'l Corp.*, 5 T. C. 892 (1945), *aff'd*, 157 F. 2d 450 (2 Cir.), *cert. denied*, 329 U. S. 733 (1946); *St. Louis Co.* v. *United States*, 237 F. 2d 151 (3 Cir. 1956), *cert. denied*, 352 U. S. 1001 (1957). Furthermore, the differences in purpose are obvious between the "deemed to have been paid" foreign tax credit provision and the "dividends paid" provision for computing personal holding company undistributed income.

Next, the taxpayer refers us to the Supreme Court decision in *Commissioner* v. *Bedford's Estate*, 325 U. S. 283 (1945). There the Court held that the boot in a recapitalization was to be treated as a dividend under §112(c)(2) of the Revenue Act of 1936, and not as a partial liquidation under §115(i) of that act. The taxpayer maintains that this decision establishes the proposition that the general definition of "dividend" (formerly Revenue Act of 1936 §115(a), now Int. Rev. Code of 1954 §316(a)) is the only limitation on the term "dividend" wherever the term is used without further explicit qualification in the Code. The Government answers that the *Bedford* case should only be interpreted to mean that the terms "dividend" and "partial liquidation" are mutually exclusive. Even if we are not prepared to agree entirely with the Government's interpretation of the *Bedford* case, it seems clear that Associated seeks to read far too much into the Supreme Court's decision.

Both parties seek support from Int. Rev. Code of 1954, §331(b), which makes §301 (relating to effects on shareholders of distributions of property) inapplicable to liquidation distributions. The Government also relies on §902(c) and (d). We have considered these sections and find them inconclusive on the point at issue before us.

A consideration of all of the above provisions of present and past revenue laws, and the relevant cases, including

Hellmich v. *Hellman, supra*,[15] leads only to the conclusion that in some contexts the term "dividend" in the Code includes liquidation distributions and in other contexts that term does not include liquidation distributions.

The answer to the question before us is not to be found by relying upon terminology, but in a consideration of the policies behind the foreign tax credit allowance generally, and the policies behind §902(a) in particular. The basic policy underlying all the foreign tax credit provisions is the elimination of double taxation. *Burnet* v. *Chicago Portrait Co.*, 285 U. S. 1 (1932); *American Chicle Co.* v. *United States*, 316 U. S. 450 (1942); *W. K. Buckley, Inc.* v. *Commissioner*, 158 F. 2d 158 (2 Cir. 1946); *Commissioner* v. *American Metal Co.*, 221 F. 2d 134 (2 Cir.), *cert. denied*, 350 U. S. 829 (1955); *Aluminum Co. of America* v. *United States*, 123 F. 2d 615 (3 Cir. 1941). But there is a well-established limitation on this policy. It is *not* the purpose of this foreign tax credit allowance to relieve taxpayers from bearing the full United States tax burden attributable to income arising from sources within this country. See H. Rep. No. 350, 67th Cong., 1st Sess. 178 (1921); H. Rep. No. 855, 76th Cong., 1st Sess. 5 (1939).[16] Moreover, the purpose of Section 902(a) is to extend the same tax treatment to a domestic corporation with a foreign subsidiary as is accorded a domestic cor-

---

[15] See also *Atlantic City Elec. Co.* v. *United States*, 161 F. Supp. 811 (Ct. Cls.), *cert. denied*, 358 U. S. 834 (1958); *Idaho Power Co.* v. *United States*, 161 F. Supp. 807 (Ct. Cls.), *cert. denied*, 358 U. S. 832 (1958); *Fowler Bros. & Cox, Inc.* v. *Commissioner*, 138 F. 2d 774 (6 Cir. 1943).

[16] H. Rep. No. 855, 76th Cong., 1st Sess. 5 (1939) states:

> The limitations on the allowance of a credit for taxes paid to foreign countries were placed in the law to make it certain that the Federal Government would receive its full tax on the income from the United States sources. It was not intended for the American tax to apply against the income from foreign sources unless the foreign tax rate was less than the tax rate imposed by the United States.

poration with a foreign branch within the same corporate shell.[17] Our decision should endeavor to effectuate these policies.

If Associated were a unitary American corporation with a foreign branch instead of an American corporate parent with foreign corporate subsidiaries, it would pay taxes to the foreign country where the branch was situated upon income derived from sources within that country, and would receive an equivalent credit on its United States income tax in the years when that foreign income was earned and taxed abroad. Accordingly, the tax credit would be offsetting an American tax at the ordinary income rates, not the capital gains rates.[18] Since foreign tax rates on ordinary income are generally higher than our capital gains rate (as in the present case) the allowance of a

---

[17] Senator Smoot explained the purpose of this provision as follows:

> This amendment extends the credit for foreign income and profits taxes paid, to a domestic corporation which owns a majority of the voting stock of a foreign subsidiary, from which subsidiary the domestic corporation receives taxable dividends.
>
> In such a case a foreign subsidiary is much like a foreign branch of an American corporation. If the American corporation owned a foreign branch, it would include the earnings or profits of such branch in its total income, but it would also be entitled to deduct from the tax based upon such income any income or profits taxes paid to foreign countries by the branch in question. Without special legislation, however, no credit can be obtained where the branch is incorporated under foreign laws.
>
> Since the foreign subsidiary may not send back to the American parent company all of its profits or earnings, it follows that the American parent company should not obtain a credit for all the income and profits taxes paid to foreign countries by the European subsidiary. The amendment in question grants only a partial or prorated credit (61 Cong. Rec. 7184 (1921)).

[18] There is no indication that Filcrest's accumulated earnings and profits were anything but ordinary income or included sales or exchanges of capital assets.

"deemed to have been paid" foreign tax credit at the time of a liquidating distribution would permit, under the mathematics of the formula in §904, a domestic corporation with a foreign subsidiary to use its foreign tax credit to offset a portion of the United States tax payable on income earned in this country. Such a result would not only be inconsistent with the treatment accorded domestic corporations that have foreign branches but would also violate the general limitation on the foreign tax credit pointed out in the preceding paragraph.

To allow the credit here would facilitate a convenient scheme for avoiding the United States income tax. A domestic corporation could set up one or more foreign subsidiaries, allow the foreign subsidiary to accumulate the income it earned abroad for several years, and then liquidate the subsidiary at the capital gains rate, claim the foreign tax credit, entirely avoid the United States ordinary income rates on the foreign income, and offset to some degree the United States tax on the corporation's American-earned income. No Congress from 1913 to the present ever "intended" such a result.

The taxpayer complains that this is double taxation. But it was within Associated's power to avoid this consequence. It could have required Filcrest to distribute its income as dividends in the ordinary course of business prior to liquidation. Then the affiliated group would clearly have been entitled to a foreign tax credit under Section 902(a).

The Court of Appeals for the Seventh Circuit in *Fowler Hosiery Co.* v. *Commissioner,* No. 13506, 7 Cir. April 13, 1962, and the Court of Claims in *Freeport Sulphur Co.* v. *United States,* 163 F. Supp. 648 (Ct. Cls. 1958), *modified on other grounds,* 172 F. Supp. 462 (1959), have rejected taxpayers' claims to "deemed to have been paid" foreign tax credits for similar reasons.

Associated makes one further point. Under the direct foreign tax credit provided in Sec. 901, a taxpayer may

under certain circumstances receive a credit for foreign "ordinary income" taxes which it could apply against the American capital gains tax. See Rev. Rul. 54-15, 1954-1 Cum. Bull. 129; cf. *Helvering* v. *Campbell*, 139 F. 2d 865, 870 (4 Cir. 1944). The Internal Revenue Code is not a high precision instrument. It lays down rules of general prescription. Circumstances sometimes arise when the statutory scheme fails to operate in accordance with the policies which motivated its creation. That such circumstances occur does not give us an excuse for failing to effectuate the general policies of the relevant Code provisions when it is possible to do so. Section 902(a) is subject to two interpretations. One facilitates tax avoidance. The other accords with the broad policies behind the foreign tax credit provisions. We accept the latter interpretation and hold that the term "dividend" in Section 902(a) does not apply to liquidation distributions. On this issue the judgment of the district court is reversed, and the case is remanded.

Affirmed in part and reversed in part.

APPENDIX C

UNITED STATES COURT OF APPEALS,
FOR THE SECOND CIRCUIT.

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the thirtieth day of July, one thousand nine hundred and sixty-two.

Present:

Hon. STERRY R. WATERMAN
Hon. J. JOSEPH SMITH
Hon. THURGOOD MARSHALL,
Circuit Judges.

ASSOCIATED TELEPHONE AND TELEGRAPH COMPANY,
Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered and decreed that the judgment of said District Court in

favor of the Government as to the consolidated return issue be and it hereby is affirmed.

FURTHER ORDERED, ADJUDGED AND DECREED that the judgment in favor of the Associated Telephone and Telegraph Company as to the foreign tax credit issue be and it hereby is reversed and the action is remanded for further proceedings in accordance with the opinion of this Court.

A. DANIEL FUSARO
Clerk

By VINCENT A. CARLIN
Chief Deputy Clerk

LIBRARY
SUPREME COURT U. S.

Office-Supreme Court, U.S
FILED
OCT 30 1962
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1962

No. 553

ASSOCIATED TELEPHONE AND TELEGRAPH COMPANY,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN SUPPORT OF PETITION FILED ON BEHALF OF COMMERCE AND INDUSTRY ASSOCIATION OF NEW YORK, INC., AS *AMICUS CURIAE*

GEORGE E. CLEARY

CLEARY, GOTTLIEB & STEEN
52 Wall Street
New York 5, N. Y.
Attorney for Commerce and Industry Association of New York, Inc., as *Amicus Curiae*

INDEX

	PAGE
STATEMENT	3
ARGUMENT	4
I. The complete denial of the foreign tax credit under the decision below is inconsistent in principle with the sole statutory limitation placed on such credit by Congress in Section 904(a)	5
II. The decision below results in double international taxation on the same income without regard to the relation between U. S. and foreign tax rates, contrary to the general purpose of the foreign income tax credit provisions	9
CONCLUSION	12

Citations

CASES:

American Chicle Co. v. *United States*, 316 U. S. 450 (1942)	2
Brace, James A., 11 T.C.M. 906 (1952)	8
Dexter, I. B., 47 B.T.A. 285 (1942)	8
Helvering v. *Campbell*, 139 F. 2d 865, 870 (4th Cir. 1944)	8

STATUTES:

Internal Revenue Code of 1954:

§ 316(a)	4, 10
§ 901 to 904	2, 9, 11, 12
§ 901(a)	4, 7, 8
§ 902(a)	2, 4, 5, 8, 9, 10, 11, 12
§ 904(a)	2, 5, 6, 7, 8, 9, 12

MISCELLANEOUS:

Rev. Rul. 54-15, 1954-1 C.B. 129	8

IN THE

Supreme Court of the United States

OCTOBER TERM 1962

No. 553

ASSOCIATED TELEPHONE AND TELEGRAPH COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN SUPPORT OF PETITION FILED ON BEHALF OF COMMERCE AND INDUSTRY ASSOCIATION OF NEW YORK, INC., AS *AMICUS CURIAE*

The Commerce and Industry Association of New York, Inc. is a membership corporation organized in 1897 under the laws of the State of New York, "to foster the trade and welfare of New York." It has a membership of some 3,500, drawn from all sections of the business world. It is the largest organization of its kind in the United States.

The Association and its members have a particular interest in foreign trade and foreign investments which are so important to the Port of New York. A large pro-

portion of its membership is engaged in foreign trade or has foreign investments of one kind or another.

Its membership includes many of the largest corporations in the United States, who have executive offices in New York City. Many of these corporations have foreign subsidiaries and hence have a very direct interest in the proper determination of the credit for foreign income taxes under the Internal Revenue Code, particularly where distributions from a foreign subsidiary are involved.

The Association and its members believe that the petition should be granted because the Court of Appeals for the Second Circuit, in conflict with principles established by this Court, has erroneously construed Section 902(a)* of the Internal Revenue Code of 1954 in such a way as to subject the earnings of foreign subsidiaries when distributed on liquidation to double international taxation, contrary to the provisions of the statute and contrary to the general purpose of Sections 901 to 904, inclusive, to prevent double taxation by the United States and foreign countries of such income. See *American Chicle Co.* v. *United States,* 316 U. S. 450 (1942).

Furthermore, the Court by its construction of the statutes has imposed a limitation on the credit for foreign income taxes, which is not provided for in the statute and which is inconsistent in principle with the sole statutory limitation on such credit provided for in Section 904(a).

The question involved in this case is an important question of Federal law which has not been but should be settled by this Court. The question seriously affects the decisions of taxpayers generally, and of members of this

* All references to Sections herein are to the Internal Revenue Code of 1954.

Association with respect to engaging in, or increasing investments in, business in foreign countries. The decision below is probably in conflict with principles established by decisions of this Court, as the construction made of the statute is not based on any terminology in the statute as enacted and reaches a result which is not consistent with the purposes of Congress as expressed in the statute.

The Association, accordingly, submits this brief *amicus curiae* in support of the petition for a writ of certiorari filed by Associated Telephone and Telegraph Company and urges that the writ be granted for the reasons set forth below.

The references to the decisions below, the statements re jurisdiction, the question presented, and the statutes and treaty involved, are adequately stated in the petition for certiorari filed by the petitioner.

The consents of the parties to this brief *amicus curiae* have been filed with the Clerk of the Court.

Statement

An American corporation in 1954 received from its wholly owned Canadian subsidiary a distribution in complete liquidation of $9,574,386.10. This distribution included $6,322,088.64 of earnings and profits accumulated by the Canadian subsidiary, on which it had paid Canadian income taxes of $2,387,564.86.

The distribution was taxed by Canada as a dividend to the extent of the earnings and profits distributed, at the rate of 5%, which tax was withheld at the source. The distribution gave rise to a large capital gain to the parent company subject to a 25% U. S. income tax.

Credit for foreign income tax has been allowed under Section 901(a) for the 5% Canadian tax on the distribution of the earnings and profits, but the Court below, reversing the District Court, held that no credit was allowable to the American parent corporation under the "deemed paid" provisions of Section 902(a) for the Canadian taxes which had been paid on the earnings and profits distributed, on the ground that the word "dividends" as used in Section 902(a) did not include a distribution of earnings and profits as part of a liquidating dividend.

Argument

The Court below concluded that the meaning of the word "dividends" as used in Section 902(a) was ambiguous. It ignored the statutory definition of the term "dividend" in Section 316(a) for all purposes of the income tax subtitle as applicable to that word as used in Section 902(a). It held that on consideration of the policies behind the foreign tax credit allowance generally and the policies behind Section 902(a) in particular, the term "dividends" as used in Section 902(a) should be construed to exclude a distribution made by a foreign subsidiary of its earnings and profits if such distribution was made by a liquidating dividend rather than an ordinary dividend. The result was that no deemed paid credit whatsoever would be allowed and there would in this case be no relief whatsoever from the double taxation of this income, notwithstanding the recognized general purpose of the statute of avoiding double taxation.

We will not duplicate here the arguments made in the petition as to the respects in which the decision below conflicts with the applicable decisions of this Court

and the meaning of the statutory language in the light of the legislative history and the treaty with Canada. We fully concur in such arguments.

We submit, however, that the solution of the problem judicially evolved below on grounds of policy, does not in fact conform to the general policies underlying the foreign income tax credit provisions and Section 902(a). On the contrary, the decision below is inconsistent in principle with the sole limitation on the foreign income tax credit which Congress provided in Section 904(a) and is in conflict with the general purpose of the foreign income tax credit provisions to prevent international double taxation of the same income. The Court's decision does not result in a proper and equitable solution of the problem of possible excessive credits, differs from and is inconsistent with the statutory solution of that problem prescribed in Section 904(a), and results in an unwarranted and inconsistent distinction between the credit for foreign taxes paid directly by the U. S. taxpayer and the credit for those deemed to be paid by him under Section 902(a). This brief is devoted primarily to these aspects of the matter.

I. The complete denial of the foreign tax credit under the decision below is inconsistent in principle with the sole statutory limitation placed on such credit by Congress in Section 904(a).

The Court below apparently was principally influenced in giving a restricted meaning to the term "dividends" as used in Section 902(a), not by any terminology or language appearing in the statute, but by the belief that otherwise the credit for the Canadian tax paid by a subsidiary on its accumulated earnings might exceed the

U. S. tax on the capital gain resulting from the distribution of such earnings to its parent in liquidation. The Court thought that Congress never "intended" such a result and that the construction evolved by it was necessary to prevent tax avoidance.

The fundamental error in this approach is the failure of the Court to recognize that Congress did intend to allow a credit for foreign taxes where necessary to avoid double taxation, did consider what limitation should be placed on the foreign tax credit and specifically provided the single limitation set forth in Section 904(a). We submit that the complete denial of the credit evolved by the Court below is inconsistent in principle with the limitation provisions of Section 904(a) and contrary to the general purpose of Congress as to what credit should be allowed and how such credit should be limited.

For the taxable year 1954, here involved, Section 904(a) provided that the total credit for foreign income taxes paid or deemed to be paid to any foreign country shall not exceed the result of the following formula:

$$\frac{\text{Taxable income from such foreign country}}{\text{Entire taxable income}} \times \text{U. S. tax.}$$

By this provision Congress made certain that if, say, 50% of the taxpayer's entire net income was from sources within this foreign country, not more than 50% of the U. S. tax could be offset by the foreign tax credit. Hence, if the average foreign income tax rate (determined by comparing the foreign tax paid or deemed to be paid with the net taxable income from the foreign country) was less than the average U. S. tax rate (determined by comparing the U. S. tax with the entire net taxable income) the credit would be allowed for the full foreign income tax paid or deemed to be paid.

The significant fact is that in Section 904(a) Congress provided for the determination of the foreign tax burden and the U. S. tax burden on an overall basis in each case. Congress did not regard it as tax avoidance to allow credit for the full foreign income tax paid or deemed to be paid so long as the average rate of foreign tax did not exceed the average rate of U. S. tax. Furthermore, in order to avoid undue double taxation Congress intended that where the average rate of foreign tax was higher, the credit should, nevertheless, be allowed up to the limit measured by the average rate of U. S. tax. Congress, of course, knew that various categories of income of U. S. individuals and corporations were taxable under U. S. law at different rates. Both individuals and corporations are taxed at progressive rates. Long term capital gains are subject to a maximum tax of 25%. Some classes of income are only partially taxable or fully exempt, etc. Congress must have known that under an infinite variety of foreign income tax laws various items or categories of income would be taxed at different rates. Congress, in its wisdom, provided that the proper, workable and simple way of determining the relative foreign and U. S. income tax burden was to determine each by a comparison of the total tax with the total relevant net income. The limitation in Section 904(a) prevents the U. S. taxpayer whose average rate of foreign income tax exceeds his average rate of U. S. income tax from relieving the U. S. income from the full U. S. tax burden attributable to it on this overall basis, but at the same time allows the credit up to this limit.

The Court below conceded that this was the proper result under Section 901(a) as to foreign taxes paid directly by a U. S. taxpayer. It notes that with respect

to the direct foreign tax credit "a taxpayer may under certain circumstances receive a credit for foreign 'ordinary income' taxes which it could apply against the American capital gains tax." This point was decided in 1942 in *I. B. Dexter*, 47 B.T.A. 285, involving capital gain fully taxable in the Philippines, but only 30% of which was then subject to U. S. tax. The same result was reached in *Helvering* v. *Campbell*, 139 F. 2d 865, 870 (4th Cir. 1944), where certain income excluded from taxable net income under U. S. law was fully taxed by the Philippines, and in *James A. Brace*, 11 T.C.M. 906 (1952), where income earned in Canada by a U. S. citizen was taxed by Canada but exempt from U. S. tax. *Brace* was allowed to include in his foreign taxes paid the Canadian tax on his earned income, which was exempt from U. S. tax, and thus to offset, subject to the limitation of Section 904(a), his U. S. tax on his other income. In the various revenue acts enacted since 1942, Congress has made no change in the statutes affecting this matter. The Commissioner finally agreed to follow the Courts, Rev. Rul. 54-15, 1954-1 C.B.-129. Hence, the alleged revenue considerations which so troubled the Court below exist today under Section 901(a), with Congressional acquiescence therein for almost 20 years.

Nevertheless, the Court below thought that such a result might be so shocking in some cases and open up such an opportunity for tax avoidance that it must give a restricted meaning to the word "dividends" as used in Section 902(a) in order to effectuate the general policy of that section, and thereby denied any tax credit whatsoever where the U. S. taxpayer received a distribution in liquidation.

Why a result which Congress has not seen fit to change for 20 years in applying Section 901(a) to foreign tax paid

directly must be avoided as a matter of policy under Section 902(a) by a harsh denial of any credit whatsoever is not explained.

The denial of any deemed paid tax credit whatsoever under Section 902(a) because the ordinary foreign income tax paid by the foreign company on its accumulated earnings may in some but not all cases exceed the U. S. tax of 25% on the capital gain is inconsistent in principle with the overall clear and specific limitation on the total credit provided by Congress in Section 904(a), and results in one rule applicable to the direct foreign tax credit and a different and inconsistent rule applicable to the deemed paid foreign tax credit.

Congress perhaps could have adopted a much more complicated plan to allow a credit for foreign income taxes paid, limited in amount to the U. S. tax on the same item of income. As a legislative body it could have considered and dealt with all the complicated ramifications of such a plan.

There is every indication in the 1954 Code as enacted that Congress did not consider or intend to adopt any such item by item allowance of or limitation on the foreign tax credit, and that it did intend to allow a credit for all foreign income taxes paid or deemed to be paid, subject only to the overall limitation on the total credit provided for in Section 904(a).

II. The decision below results in double international taxation on the same income without regard to the relation between U. S. and foreign tax rates, contrary to the general purpose of the foreign income tax credit provisions.

There can be no question but that the general purpose of Sections 901 to 904 was to prevent undue international

double taxation of the income of a U. S. taxpayer derived from sources in a foreign country by permitting a credit against the U. S. tax for the foreign taxes paid on income also taxable by the United States. The Court below states this principle and cites the authorities:

There can be no question but that the general purpose of Section 902(a) was to permit a qualified U. S. corporate stockholder, in the year when such foreign profits were distributed to it as "dividends," to treat as foreign income taxes paid by it for this purpose, the foreign income taxes theretofore paid by the foreign corporation on the accumulated profits distributed, so that what was essentially the same income would not bear the burden of both the foreign and U. S. income tax.

The Court below, by giving the word "dividends" as used in Section 902(a) a more restricted meaning than it has in the statutory definition of "dividend" in Section 316(a), holds that no credit whatsoever for foreign income taxes paid by the foreign corporation on these accumulated earnings is allowed by the statute if such accumulated earnings are distributed to the American stockholder as a liquidating dividend rather than as an ordinary dividend.

The result is to cause this income to remain fully subject to such income taxes as the United States and as Canada chose to impose thereon, with no relief whatsoever from this double taxation.

The Court justifies its construction on the ground that otherwise in some cases the credit for the foreign income tax on a particular item or type of income might exceed the U. S. tax on that particular item or type of income, thus giving an opportunity in some cases for what the Court regarded as tax avoidance.

The Court's construction of the statute is, of course, equally applicable whether the foreign tax rate is more or less than the U. S. tax rate on the particular item.

If the foreign tax rate is 20% and the U. S. tax rate is 25%, the decision below leaves the income fully subject to both taxes, with no credit whatsoever for the lower foreign income taxes.

If the foreign tax rate is 30% and the U. S. tax rate is 25%, the decision below does not merely limit the credit to 25%, the U. S. rate, which is the general plan of the statute, but denies the credit altogether, leaving the income fully subject to both taxes.

Thus, while recognizing that the primary purpose of the foreign tax credit provisions was to eliminate double taxation, the Court below, because of its concern that the foreign tax rate on the item of income in question was higher than the U. S. tax rate on the same item of income, decided the case on a basis resulting in serious double taxation.

The Court below in construing the word "dividends" as used in Section 902(a) has thus reached a result which, when considered in the light of the policy underlying Sections 901 to 904,

(a) is inconsistent with the general statutory purpose of avoiding international double taxation;

(b) denies any credit whatsoever for foreign income taxes deemed to be paid where the accumulated profits are distributed in liquidation, whether or not the foreign tax rate exceeds the U. S. tax rate on the same income;

(c) in such a case, does not merely limit the credit to the amount of U. S. tax on the same income, which is the general pattern of the statute, but denies the credit

altogether in a situation where double taxation obviously exists.

We submit that the decision below defeats rather than promotes the general policies underlying Sections 901 to 904 and since based on policy grounds, rather than statutory terminology, should be reversed.

The petitioner's position, in contrast, fully accords with the general policy of eliminating undue double taxation.

The problems of excessive credits and possible tax avoidance, which were of decisive weight with the lower Court, are adequately dealt with and provided for by Congress in Section 904(a). (See Point I, *supra*). Congress having set the limits on the total allowable credit, these problems, which were the main basis for the decision below, are of no significance in construing the statute from the standpoint of underlying policies and purposes, and hence do not warrant the decision below.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

GEORGE E. CLEARY

George E. Cleary
CLEARY, GOTTLIEB & STEEN
52 Wall Street
New York 5, New York
Attorney for COMMERCE AND INDUSTRY ASSOCIATION OF NEW YORK, INC., as *Amicus Curiae*.

LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
13 1952

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	3
Argument	5
Conclusion	10

CITATIONS

Cases:

American Chicle Co. v. *United States*, 316 U.S. 450 7

Commissioner v. *Estate of Bedford*, 325 U.S. 283 6

Foster v. *United States*, 303 U.S. 118 6

Fowler Hosiery Co. v. *Commissioner*, 301 F. 2d 394 6

Freeport Sulphur Co. v. *United States*, 163 F. Supp. 648, addendum, 172 F. Supp. 462 6

Hellmich v. *Hellman*, 276 U.S. 233 ..... 5, 6

669218—62

Statutes:

	Page
Internal Revenue Code of 1954:	
Sec. 316 (26 U.S.C. 316)	2, 5
Sec. 331 (26 U.S.C. 331)	2, 5
Sec. 901 (26 U.S.C. 901)	3
Sec. 902 (26 U.S.C. 902)	3
Sec. 902(a) (26 U.S.C. 902(a))	4, 5, 7, 9
Secs. 951–964 (26 U.S.C. 951–964)	8
Sec. 1248 (26 U.S.C. 1248)	7–8
Revenue Act of 1918, c. 18, 40 Stat. 1057	5
Revenue Act of 1962, Public Law 87–834, 76 Stat. 960	7
Miscellaneous:	
H. Rep. No. 2319, 81st Cong., 2d Sess., p. 52 (1950–2 Cum. Bull. 380, 419–420)	6
H. Rep. No. 1447, 87th Cong., 2d Sess., p. A124	9
S. Rep. No. 1881, 87th Cong., 2d Sess., p. 300	9

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 553

ASSOCIATED TELEPHONE AND TELEGRAPH COMPANY,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B–1—B–19) is reported at 306 F. 2d 824. The opinion of the district court (R. 64a–131a)[1] is reported at 199 F. Supp. 452.

JURISDICTION

The judgment of the court of appeals was entered on July 30, 1962 (Pet. App. C–1—C–2). The petition for a writ of certiorari was filed on October 24, 1962. The time for filing the government's response was extended to December 13, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and 2101 (c).

[1] "R. ——" references are to the Joint Appendix in the court of appeals.

QUESTION PRESENTED

Whether the term "dividends," as used in Section 902(a) of the Internal Revenue Code of 1954, relating to the credit for foreign taxes, includes a distribution in complete liquidation of a wholly-owned foreign subsidiary.

STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 316. DIVIDEND DEFINED.
>
> (a) *General Rule.*—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—
>
> (1) out of its earnings and profits accumulated after February 28, 1913, or
>
> (2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.
>
> * * * * *
>
> (26 U.S.C. 316.)
>
> SEC. 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS.
>
> (a) *General Rule.*—
>
> (1) *Complete liquidations.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.
>
> * * * * *
>
> (26 U.S.C. 331.)

SEC. 901. TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES.

(a) *Allowance of Credit.*—If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the applicable limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under section 902. * * *

* * * * *

(26 U.S.C. 901.)

* * * * *

SEC. 902. CREDIT FOR CORPORATE STOCKHOLDER IN FOREIGN CORPORATION.

(a) *Treatment of Taxes Paid by Foreign Corporation.*—For purposes of this subpart, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits.

* * * * *

(26 U.S.C. 902.)

STATEMENT

The petitioner ("Associated"), a Delaware corporation, filed a consolidated income tax return for 1954

with its wholly-owned American subsidiary, Automatic Electric Co. ("Automatic") which, in turn, was the sole stockholder of Filcrest Co., Ltd. ("Filcrest"), a Canadian corporation completely liquidated in 1954. The liquidating distribution to Automatic included earnings and profits of Filcrest upon which Canadian income taxes had previously been paid. Canadian income tax was also paid upon the liquidating distribution itself. The gain realized upon the liquidation was reported in the consolidated return as a long-term capital gain. (R. 42a–45a.)

Credits for foreign taxes were claimed on the consolidated income tax return under both Sections 901 and 902 of the Internal Revenue Code of 1954. The Commissioner allowed the Section 901 credit for the Canadian tax imposed directly upon the parent in connection with the payment of the liquidating distribution (R. 44a–45a). The Section 902 credit, however, for Canadian taxes paid by Filcrest upon the accumulated earnings and profits included in the liquidating distribution, was disallowed on the ground that a liquidating distribution is not a "dividend" for purposes of Section 902(a) of the Code. (R. 45a–46a.) Petitioner paid the tax and sued for a refund. The district court held that the liquidating distribution qualified as a "dividend" within the meaning of Section 902(a) and that the petitioner was entitled to the deemed paid credit. The court of appeals, reversing the district court on this issue,[2] held "that the term 'dividend' in Section 902(a) does not apply to liquidation distributions." (Pet. App. B–19.)

[2] Another consolidated returns issue decided for the government by the courts below is not raised by the petition.

ARGUMENT

The decision below is correct, is not in conflict with any other decision, and presents no issue of continuing importance.

1. Under Section 902(a) of the 1954 Revenue Code, a domestic corporation, in any year it receives "dividends" from a foreign subsidiary, is "deemed to have paid," and hence is entitled to credit for the foreign income tax paid by the subsidiary on that portion of the accumulated earnings which the "dividends" represent. The sole question in this case is whether a "dividend," for purposes of this section, includes a distribution in complete liquidation of a wholly-owned subsidiary. The court of appeals properly held it did not.

In the landmark case of *Hellmich* v. *Hellman*, 276 U.S. 233, 237, this Court held that "as generally understood and used, [the term 'dividend'] refers to the recurrent return upon stock paid to stockholders by a going corporation in the ordinary course of business, which does not reduce their stock holdings and leaves them in a position to enjoy future returns upon the same stock." A liquidating distribution, of course, does not meet this test.

The distinction between "dividends" and "distributions made to stockholders in the liquidation of a corporation," expounded by *Hellmich* v. *Hellman*, *supra*, in the context of the Revenue Act of 1918, c. 18, 40 Stat. 1057, has been maintained ever since and is now reflected in Sections 316 and 331 of the Internal Revenue Code of 1954, *supra*, p. 2. Under the latter section, distributions in liquidation, unlike dividends,

are "treated as * * * payment in exchange for the stock," and have tax consequences completely different from those attaching to dividends. See, e.g., *Foster* v. *United States*, 303 U.S. 118. Indeed, the present petitioner had the benefit of that distinction when it obtained long-term capital gain, rather than ordinary income, treatment upon liquidation of the Canadian subsidiary. (R. 45a.)

2. The petition alleges no direct conflict with any other decision, and there is none. On the contrary, the decision below is in accord with those of the Seventh Circuit in *Fowler Hosiery Co.* v. *Commissioner*, 301 F. 2d 394, and of the Court of Claims in *Freeport Sulphur Co.* v. *United States*, 163 F. Supp. 648, addendum, 172 F. Supp. 462. Although the opinions vary somewhat in the weight placed upon particular arguments supporting the government's position,[3] they are in full agreement in their construction of the statutory language. If anything, these differences in emphasis merely demonstrate that there are additional valid grounds for the decision below.

Furthermore, the "rules enunciated by this Court," upon which petitioner relies, bear on this case only remotely, if at all. *Commissioner* v. *Estate of Bedford*, 325 U.S. 283, 289 (see Pet. 7–8), involved the question

---

[3] For example, the Seventh Circuit and the Court of Claims placed greater weight than did the court below upon this Court's decision in *Hellmich* v. *Hellman*, 276 U.S. 233. Also, the court below, unlike the Seventh Circuit, did not rely upon the 1950 comment of the House Ways and Means Committee (H. Rep. No. 2319, 81st Cong., 2d Sess., p. 52 (1950–2 Cum. Bull. 380, 419–420) on proposed Section 206 of the Revenue Bill of 1950), to the effect that the indirect foreign tax credit is not available with respect to distributions in liquidation of foreign corporations.

whether a cash "boot" distributed to a taxpayer on the recapitalization of a corporation "has the effect of the distribution of a taxable dividend" under Section 112(c)(2) of the 1936 Revenue Act, and therefore was properly taxed at ordinary income rates, notwithstanding taxpayer's argument that the distribution more nearly had the effect of a "partial liquidation" under Section 115(i) of that Act. In requiring dividend treatment, this Court did not hold, as petitioner here suggests, that payments admittedly taxable as liquidating distributions under what is now Section 331 must for all other purposes be considered as dividends. *American Chicle Co.* v. *United States*, 316 U.S. 450 (see Pet. 8–9), states merely that the general purpose of Section 902(a) is to avoid double taxation; it does not deal even inferentially with the question presented here. The remaining "rules" allegedly contravened by the decision below are merely general guides to statutory construction which were given their proper weight.

3. Recent amendments of the Internal Revenue Code deprive the present case of any significance with respect to similar distributions of earnings and profits accumulated in taxable years beginning subsequent to December 31, 1962. Section 1248 of the Code, added by Section 15 of the 1962 Revenue Act,[4] 76 Stat. 960,

[4] The relevant portions of Section 15 are as follows:

(a) TREATMENT OF GAIN FROM THE REDEMPTION, CANCELLATION, OR SALE OF STOCK IN CERTAIN FOREIGN CORPORATIONS.—Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses) is

1041, substantially ends the capital gains treatment of accumulated earnings and profits of a foreign corporation when distributed in liquidation to an American stockholder owning at least 10 percent of the voting stock. Instead, the gain realized by the stockholder on the liquidating distribution, to the extent

---

amended by adding after section 1247 (as added by section 14 of this Act) the following new section:

"SEC. 1248. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS.

"(a) GENERAL RULE.—If—

"(1) a United States person sells or exchanges stock in a foreign corporation, or if a United States person receives a distribution from a foreign corporation which, under section 302 or 331, is treated as an exchange of stock, and

"(2) such person owns, within the meaning of section 958(a), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such foreign corporation was a controlled foreign corporation (as defined in section 957),

then the gain recognized on the sale or exchange of such stock shall be included in the gross income of such person as a dividend, to the extent of the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary or his delegate) to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock sold or exchanged was held by such person while such foreign corporation was a controlled foreign corporation. * * *"

* * * * *

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to sales or exchanges occurring after December 31, 1962.

See also new Sections 951–964 of the Code, added by Section 12 of the 1962 Act.

it is attributable to accumulated earnings and profits, will be taxed as a dividend, at ordinary income rates.

Significantly, the Senate Finance Committee report on the new section states (S. Rep. No. 1881, 87th Cong., 2d Sess., p. 300; see also H. Rep. No. 1447, 87th Cong., 2d Sess., p. A124):

> To the extent gain is included in gross income as a dividend, the pertinent rules of subpart A of part III of subchapter N, relating to foreign tax credits, apply. Thus, foreign-tax credits for amounts allowed under section 901(b) with respect to taxes paid, and section 902 with respect to taxes deemed to be paid, are allowable if the U.S. person chooses to have the benefits of such sections. That part of the gain in excess of the amount included in gross income as a dividend under section 1248 is treated as provided by the code without regard to new section 1248 *and there is no foreign tax credit with respect to taxes paid by the foreign corporation as to the portion of the gain that is not a dividend.* [Emphasis supplied.]

It is clear, therefore, that the future treatment of liquidating distributions such as the one involved here has been definitively settled by Congress. For taxable years commencing on or after January 1, 1963, the foreign tax credit provided by Section 902(a) will be available as to that portion of a liquidating distribution which is taxable to the American stockholder as a dividend at ordinary income rates, but will be unavailable as to that portion of the distribution which is taxable at capital gain rates. In light of this new provision, resolution of the issue by this Court is unnecessary

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
RICHARD M. ROBERTS,
Acting Assistant Attorney General.
HAROLD C. WILKENFELD,
Attorney.

DECEMBER 1962.

U.S. GOVERNMENT PRINTING OFFICE: 1962

SUPREME COURT, U. S.
LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
DEC 20 1962
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1962.

No. 553

ASSOCIATED TELEPHONE AND TELEGRAPH COMPANY,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

JOHN J. BOLAND,
WINTHROP, STIMSON, PUTMAN & ROBERTS
40 Wall Street,
New York 5, N. Y.
Attorney for Petitioner

Of Counsel:
THEODORE F. BROPHY,
ROBERT ADELSON,
730 Third Avenue,
New York, N. Y.

ROBERT P. ADELMAN,
40 Wall Street,
New York, N. Y.

December 20, 1962.

Pandick Press, Inc., 22 Thames St., New York 6, N. Y., U. S. A.

IN THE

Supreme Court of the United States

OCTOBER TERM 1962.

No. 553

ASSOCIATED TELEPHONE AND TELEGRAPH COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

1. The issue herein is of substantial and continuing significance. Respondent's argument in its Brief in Opposition ("Br. Opp." p. 7ff.) to the contrary is invalid.

Respondent, as the basis of its argument, purports to quote (Br. Opp. p. 7, n. 4) the "relevant" portions of §15 of the Revenue Act of 1962, P. L. 87-834, 76 Stat. 960 (the "1962 Act"), which added new §1248 to the Internal Revenue Code of 1954 (the "1954 Code"). Respondent, however, fails to quote or even refer to subsection (d)(3)*

* Section 1248(d)(3) provides in pertinent part:

"(d) EXCLUSIONS FROM EARNINGS AND PROFITS. For purposes of this section, the following amounts shall be excluded, with respect to any United States person, from the earnings and profits of a foreign corporation:

* * * * *

"(3) LESS DEVELOPED COUNTRY CORPORATIONS. Earnings and profits accumulated by a foreign corporation while

of §1248 which clearly is relevant and expressly excludes accumulated earnings of "less developed country corporations"* from the special tax computation rules of such section. Thus, contrary to Respondent's contention, the issue herein has very substantial and continuing significance with respect to liquidating dividends from post-1962 earnings and profits distributed by "less developed country corporations"—which may well include foreign subsidiary corporations doing business in Central and South America, Asia, Africa, portions of Europe and possessions of the United States.

Resolution of the issue by this Court is actually now more important than before the 1962 Act. The foreign tax rates in "less developed countries" are *generally lower* than the United States capital gain rate. Hence, a serious question is now presented as to the applicability after 1962 of the decisions below and in *Fowler Hosiery Co., Inc.* v. *Comm'r*, 301 F. 2d 394 (7th Cir. 1962) which were largely predicated upon the assumption that the foreign tax rates involved would be *generally higher* than the United States capital gain rate.

The continuing capital gain treatment provided under the 1962 Act for the liquidation of "less developed country

---

it was a less developed country corporation (as defined in section 902(d)), if the stock sold or exchanged was owned for a continuous period of at least 10 years, ending with the date of the sale or exchange, by the United States person who sold or exchanged such stock."

See also S. Rep. No. 1881, 87th Cong., 2d Sess. (1962).

* A "less developed country corporation" is defined in §§902(d) and 955(c)(1) of the 1954 Code, generally, as a foreign corporation doing business in a "less developed country." A "less developed country" is defined for this purpose in §955(c)(3) of the 1954 Code as any foreign country (outside the Sino-Soviet Bloc) or United States possession so designated from time to time by Executive Order of the President with the exception of 21 countries specified therein.

corporations" (whether the gain be attributable to earnings and profits accumulated before, during or after 1962) was obviously designed to encourage the establishment and extension of subsidiary operations in the underdeveloped areas of the world. It would be contrary to such Congressional policy to require double international taxation of such subsidiaries' earnings (through denial of any foreign tax credit under §§901 and 902 of the 1954 Code) merely because they are remitted to the United States in the form of liquidating dividends and thereby qualify for the intended capital gain relief. Frequently economic and political changes in less developed countries leave no choice but liquidation of such subsidiaries.

Furthermore, §1248 has no application whatever to earnings accumulated prior to 1963 regardless of where the foreign corporation is engaged in business, when it is liquidated, or how long its stock was owned.

In any event, §1248* makes no reference to foreign tax credits generally, or to §902 in particular. The Senate Finance Committee Report (S. Rep. No. 1881, 87th Cong., 2d Sess. 300 (1962), quoted by Respondent at Br. Opp. p. 9) as well as the House Ways and Means Committee Report (H. R. Rep. No. 1447, 87th Cong., 2d Sess. A124 (1962)) expresses no opinion as to the applicability of the foreign tax credit "provided by the code without regard to new section 1248" except to indicate that there is no foreign tax credit with respect to "the portion of the gain

---

* Section 1248 was added to Part IV of Subchapter P of Chapter 1 of the 1954 Code, relating to "SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES", and merely provides special tax computation rules whereby long-term capital gains realized on the sale or exchange of stock in certain foreign corporations (except "less developed country corporations") are taxed at ordinary income rates to the extent of post-1962 earnings and profits.

that is not a dividend". The 1962 Act Committee Reports thus leave open the question of whether a distribution of accumulated earnings in partial or complete liquidation is a "dividend" within the meaning of §902(a) in the absence of the special tax computation rules of §1248. This is the very issue which should be resolved by this Court.

Moreover, this Court has indicated that any observation or implication in a Congressional committee report *issued many years subsequent to the enactment of the original section in question* (§238(e) of the Revenue Act of 1921, c. 136, 42 Stat. 227) is entitled to no weight.*

2. Respondent relies upon some general language in *Hellmich* v. *Hellman*, 276 U. S. 233 (1928), in a context completely different from that in the instant case, for Respondent's view that the term "dividends" can never include a distribution of earnings and profits in liquidation. (See Br. Opp. p. 5.) The Respondent similarly relied upon the *Hellman* case in the Court below, but such argument was rejected.** The *Hellman* case involved the taxability to an individual shareholder of liquidating distributions under the Revenue Act of 1918, c. 18, 40 Stat. 1057; and this Court

---

* See *Penn Mutual Life Ins. Co.* v. *Lederer*, 252 U. S. 523 (1920) in which Justice Brandeis stated:

> "But no aid could possibly be derived from the legislative history of another act passed nearly six years after the one in question. Further answer to the argument based on the legislative history of the later act would, therefore, be inappropriate." 252 U. S. at 538.

See also *U. S.* v. *Wise*, 370 U. S. 405 (1962). This principle was recognized by the Court below in the instant case (see Petition, Appendix B, pp. 10-11), as well as in *Fire Companies Bldg. Corp.* v. *Comm'r*, 54 F. 2d 488, 489 (2d Cir. 1931), *cert. denied*, 286 U. S. 546 (1932). Such principle is also applicable to the observation of the House Ways and Means Committee in 1950, referred to in Br. Opp. p. 6, n. 3.

** See Petition, Appendix B, pp. 10, 16.

held that under the *express terms* of §201(c) of such Act, liquidating distributions were *taxable* as "other gains or profits" and, accordingly, could not qualify for the "dividends received" deduction allowed under §216(a) of such Act. Moreover, the most recent expression of opinion by this Court (*Comm'r* v. *Est. of Bedford*, 325 U. S. 283, 291, 292 (1945))—*that the general definition of "dividend" in §316(a) of the 1954 Code is applicable to the entire income tax subtitle*—is controlling herein in the absence of any language qualifying the term "dividends" as used in §902(a) of the 1954 Code. (See Petition, pp. 7, 8.)

In further support of its *Hellman* argument, Respondent indicates that under §331 of the 1954 Code, liquidating distributions "have tax consequences completely different from those attaching to dividends." (Br. Opp. p. 6.) This simply means that by reason of §331 liquidating dividends are taxable at capital gain rates. There is no language in §§316(a), 331(a) or any other statutory provision which excludes liquidating dividends from the meaning of the term "dividends" as used in other contexts in the 1954 Code such as the foreign tax credit provisions. While the Respondent recognizes that the purpose of §902(a) "is to avoid double taxation," citing *American Chicle Co.* v. *U. S.*, 316 U. S. 450 (1942) (Br. Opp. p. 7), he disregards the point basic to this issue, *viz.*, that the lower court decisions, which were based upon tax rate differentials, result in the very type of international double taxation of income which the foreign tax credit provisions (as well as the income tax conventions with foreign countries) are designed to prevent.

3. Although, as Respondent recognizes (Br. Opp. p. 6), there is conflict in reasoning among the lower courts on this issue, Respondent does not dispute that all of such deci-

sions rest primarily upon a comparison of foreign tax rates and the United States capital gain rate on a *particular item* of income. Such decisions, therefore, are completely inconsistent with the pattern of the statutory limitation on foreign tax credits contained in §904 of the 1954 Code.* (See Petition pp. 9-11.)

Respectfully submitted,

John J. Boland

JOHN J. BOLAND
WINTHROP, STIMSON, PUTNAM & ROBERTS
40 Wall Street
New York 5, N. Y.
Attorney for Petitioner

Of Counsel:

THEODORE F. BROPHY
ROBERT ADELSON
730 Third Avenue
New York, N. Y.

ROBERT P. ADELMAN
40 Wall Street
New York, N. Y.

December 20, 1962

---

* It was not until the enactment of §10 of the 1962 Act (adding new subsection (f) to §904 of the 1954 Code) that the Congress required a separate foreign tax credit limitation based upon a *particular item* of income, *viz.*, certain interest income derived from foreign sources. As is apparent from the Senate Finance Committee Report (S. Rep. No. 1881, 87th Cong., 2d Sess. 72 ff.) the Congress understood perfectly well that hitherto there was no separate limitation in the foreign tax credit provisions based upon the rates of tax applicable to specific types of income (whether taxed at capital gain rates or otherwise).